

**Michigan State Police Retirement System**  
a Pension Trust Fund of the State of Michigan

**Comprehensive Annual Financial Report  
for the Fiscal Year Ended September 30, 2007**



**M S P R S**

**Prepared by:  
Financial Services  
for  
Office of Retirement Services  
P.O. Box 30171  
Lansing, Michigan 48909-7671  
517-322-5103  
1-800-381-5111**

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# INTRODUCTORY SECTION

Certificate of Achievement  
Public Pension Standards Award  
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Retirement Board Members  
Advisors and Consultants  
Organization Chart

# INTRODUCTORY SECTION

## Certificate of Achievement

### Certificate of Achievement for Excellence in Financial Reporting

Presented to

### Michigan State Police Retirement System

For its Comprehensive Annual  
Financial Report  
for the Fiscal Year Ended  
September 30, 2006

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



*Charles S. Cox*

President

*Jeffrey R. Enen*

Executive Director

**Public Pension Standards Award**



**Public Pension Coordinating Council  
Public Pension Standards**

***2007 Award***

Presented to

**Michigan Office of Retirement Services**

In recognition of meeting professional standards for  
plan design and administration as  
set forth in the Public Pension Standards.

*Presented by the Public Pension Coordinating Council, a confederation of*

National Association of State Retirement Administrators (NASRA)  
National Conference on Public Employee Retirement Systems (NCPERS)  
National Council on Teacher Retirement (NCTR)

A handwritten signature in cursive script, reading 'Alan H. Winkle'.

Alan H. Winkle  
Program Administrator

# **INTRODUCTORY SECTION**

## **Letter of Transmittal**

**State Police Retirement System**  
P.O. Box 30171  
Lansing, Michigan 48909-7671  
Telephone 517-322-5103  
Outside Lansing 1-800-381-5111

### **STATE OF MICHIGAN**

JENNIFER M. GRANHOLM, Governor

## **DEPARTMENT OF MANAGEMENT AND BUDGET**

December 14, 2007

The Honorable Jennifer M. Granholm  
Governor, State of Michigan,

Members of the Legislature  
State of Michigan,

Retirement Board Members  
and  
Members, Retirees and Beneficiaries

Ladies and Gentlemen:

We are pleased to present the comprehensive annual financial report of the Michigan State Police Retirement System (System) for fiscal year 2007.

### **INTRODUCTION TO REPORT**

The System was established by legislation under Public Act 251 of 1935. It now operates under the provisions of Public Act 182 of 1986, as amended, and is administrated by the Office of Retirement Services (ORS). The number of active and retired members and beneficiaries of the System is presented in Note 1 of the financial statements in the Financial Section of this report. The purpose of the System is to provide benefits for all State Police. The services performed by the staff provide benefits to members.

#### ***Responsibility***

Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the leadership team of the System. To the best of our knowledge and belief, the enclosed data is accurate in all material respects and is reported in a manner designed to present fairly the financial position and results of operations of the System.

#### ***Internal Control Structure***

The leadership team of the System is responsible for maintaining adequate internal accounting controls designed to provide reasonable assurance that transactions are executed in accordance with management's general or specific authorization, and are recorded as necessary to maintain accountability for assets and to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America. The internal

## **Letter of Transmittal (Continued)**

control structure is designed to provide reasonable assurance regarding the safekeeping of assets and reliability of all financial records.

### ***Independent Auditors***

Andrews Hooper & Pavlik P.L.C., independent auditors, conducted an annual audit of the System. The independent auditor's report on the System's financial statements is included in the Financial Section of this report.

Statute requires that an annual actuarial valuation be conducted. The purpose of the valuation is to evaluate the mortality, service, compensation and other financial experience of the System and to recommend employer-funding rates for the subsequent year. This annual actuarial valuation was completed by Gabriel Roeder Smith & Company for the fiscal year ended September 30, 2006. Actuarial certification and supporting statistics are included in the Actuarial Section of this report.

### ***Management's Discussion and Analysis (MD&A)***

Generally Accepted Accounting Principles (GAAP) require that management provide a narrative introduction, overview, and analysis to accompany the Basic Financial Statements in the form of MD&A. This letter of transmittal is intended to complement MD&A and should be read in conjunction with it. The MD&A can be found immediately following the Independent Auditor's Report.

## **PROFILE OF THE GOVERNMENT**

The State Police Retirement System was created by Public Act 251 of 1935 and later superseded by Public Act 182 of 1986. A nine-member board, under the direction of a chairperson elected from the membership, administers the System to provide retirement benefits for State Police officers. Financing is provided by investment income and by an annual legislative appropriation.

## **ECONOMIC CONDITIONS AND OUTLOOK**

Despite challenging economic times, the System continues to show strong performance.

### ***Investments***

The State Treasurer is the investment fiduciary and custodian of all investments of the System pursuant to State law. The primary investment objective is to maximize the rate of return on the total investment portfolio, consistent with a high degree of prudence and sufficient diversity to eliminate inordinate risks and to meet the actuarial assumption for the investment return rate. The investment activity for the year produced a total rate of return on the portfolio of 17.4%. For the last five years, the System has experienced an annualized rate of return of 14.0%. A summary of asset allocation and rates of return can be found in the Investment Section of this report.

### ***Accounting System***

Transactions of the System are reported on the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when incurred. Participants' benefits are recorded when payable by law. We believe the accounting and administrative internal controls established by the System provide reasonable assurance the System is carrying out its responsibilities in safeguarding its assets, in maintaining the reliability of the financial records for preparing financial statements, and in maintaining accountability for its assets.

# **INTRODUCTORY SECTION**

## **Letter of Transmittal (Continued)**

### ***Funding***

Funds are derived from the excess of additions to plan net assets over deductions from plan net assets. Funds are accumulated by the System in order to meet future benefit obligations to retirees and beneficiaries. The percentage computed by dividing the actuarial value of assets by the actuarial accrued liability is referred to as the “funded ratio.” This ratio provides an indication of the funding status of the System and generally, the greater this percentage, the stronger the System. Effective in fiscal year 2001, the System used the actuarial valuation from the previous fiscal year for this report.

This approach is consistent with Governmental Accounting Standards Board (GASB) Statement No. 25. Consistent with this approach, the most recent actuarial valuation was performed as of September 30, 2006. The actuarial value of the assets and actuarial accrued liability of the System were \$1.2 billion and \$1.4 billion, respectively, resulting in a funded ratio of 86.9% at September 30, 2006. A historical perspective of funding levels for the System is presented on the Schedule of Funding Progress in the Required Supplementary Information in the Financial Section of this report.

### ***Postemployment Benefits***

In fiscal year 2007 the System implemented Governmental Accounting Standards Board (GASB) Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. A GASB 43 compliant actuarial valuation was completed as of September 30, 2006, to determine the actuarial accrued liability if the postemployment benefits were to be pre-funded. If these benefits were pre-funded, the actuarial accrued liability would be \$944.4 million. Statement No. 43 does not require retroactive application of the reporting changes. Therefore, in this year of transition, only one valuation year is presented and is included in the required supplementary information of this report.

## **MAJOR GOALS ACCOMPLISHED**

The Michigan Department of Management and Budget (DMB), Office of Retirement Services (ORS) is a customer focused organization that serves its members and employees today and prepares them for tomorrow. Progress in fiscal year 2007 has allowed us to do so better than ever before – we are providing better and faster service to customers, we reengineered our processes, and have nearly completed our “Vision ORS” technology project. Below are some of the highlights.

### ***Focus on Our Customer***

Customer contact — Most of our customers still view the telephone as their primary means of communicating; this year our representatives answered 225,611 calls. A growing number of customers have found email correspondence better meets their busy lifestyles as demonstrated by the 19,099 pieces of correspondence we responded to this year. Our staff also provided face-to-face interaction with 8,206 individuals who visited our office.

Pension payroll system — We deployed a new system that permits daily payroll runs; customers no longer have to wait for a monthly run to receive a refund, adjustment, or first pension payment. It also relieves bottlenecks in workload processing caused by trying to meet monthly deadlines.

Customer self-service — This project will allow active members and retirees to access account information and perform transactions via a secure website. In order to get to this point, subject matter experts gathered requirements to create bid documents for vendors. The planning sessions dove deep into the inner workings of our retirement administration system to finalize exactly what we wanted our members to do online and how they would go about doing it.



## **Letter of Transmittal (Continued)**

### ***Continuously Improve Processes***

Reengineering — To ensure we are making the most of our new technology tools, we reengineered 77 processes within the organization. This effort identified efficiencies, and found many ways to improve the speed and quality of services to our customers. We have expanded this reengineering to other administrations within the State's Department of Management and Budget.

File imaging — ORS is reaching "paperless" status: nearly all of our old paper files have now been scanned into electronic images. In 2007, we imaged 63,643 member files, 551,808 paper documents, and 254,630 microfiche documents so that staff can quickly access the files with a few clicks of a mouse rather than waiting for a paper file to be delivered. By dismantling and eliminating the need for our paper files prior to the office renovation we will save \$7,040 in fiscal year 2007.

Recalculating pensions — Legislation passed earlier this year requiring ORS to recalculate pensions and give credit to qualified state police retirees who accrued Banked Leave Time from 1957 through 1963. This also increased cost of living adjustments (COLA) for retirees who had not hit the COLA cap (3% or \$25.00). Because the system is set up to copy the same COLA amount as the previous year, a subsequent project involved manually calculating the new amount and putting it into the system before the regular COLA increase program ran in October.

Two of our staff members had only a small window of time to get all of the adjustments done. They were able to complete this project in three days, manually calculating, adjusting and auditing approximately 600 COLAs on state police accounts.

### ***Promote a Positive Work Environment***

Strategic planning — ORS engaged an all-inclusive approach to strategic planning. The entire staff participated in a group session to identify business issues of importance. Volunteer work groups also worked together to craft the seven strategic goals that will direct ORS for the next three-five years.

All-Staff meetings — ORS hosted two meetings to honor the hard work and dedication of its staff and to deliver direct, relevant business news. The first meeting included our annual presentation of the ORS Excellence Awards to celebrate staff nominated for awards in the categories of Customer Service, Every Day Hero, Innovator, Leadership, and Living the Values. The second meeting focused heavily on upcoming technology and customer service tools that will allow staff to do their jobs with greater ease.

### ***Optimize Technology***

Forms, letters, and bar-coding project — When a customer requests a form, the system will pre-populate certain form fields so the customer only needs to provide the information not already contained in our system. Adding barcodes to the forms streamlines the process. The project also includes a process that electronically collects all correspondence and forms requests each day, and uses a secure website to send documents to the State's central printing and mail facility, increasing the efficiency and security of our print and mail process.

In fiscal year 2007 we reviewed, updated, and tested 160 forms, creating greater efficiencies and offering better customer service. We are nearing final implementation stages.

# INTRODUCTORY SECTION

## Letter of Transmittal (Continued)

Server replacement — A major project to replace existing servers with new hardware and upgrade some of the middleware software versions is complete. This upgrade was accomplished with support from several different areas in the business and provides enhanced functionality and additional performance improvements.

Of special significance is the introduction of a separate set of servers that mirror our production servers and will serve as our disaster recovery site. The separate servers are located in a different building from our production servers and will be used for technical testing. The servers will always be ready to take over if there should be an emergency.

Workforce management software — Software implemented in our customer service center uses historical activity data to forecast future customer demands. Monitoring the workload volumes for a variety of time intervals assists with scheduling staff for phone and non-phone activities to provide better customer service.

### ***Invest in Employee Development***

Customer Service Center training — Staff created and executed contact center training for new employees. Trainees attended formal classroom sessions and were tested on the information presented. Topics included an overview of the retirement systems, software programs, and telephone etiquette. Subject matter experts shared valuable knowledge on insurance, service credit, eligibility, and preretirement topics. Trainees also observed contact center staff during customer calls.

Workforce development staff — The development staff created a series of six training videos to help staff stay on top of new software and program features and techniques. The training videos utilized software that allowed us to connect with our audience by creating interactive video tutorials that were posted online and offered free of charge to all staff in DMB.

Competency Based Training reviews — Senior leadership met individually with every employee and their direct supervisor to ensure each employee is given the opportunity to do what they do best on a daily basis. In addition employees are able to share their personal progress and challenges from the past year, and speak out about any suggestions they have for ways our organization could best utilize their skills.

### **AWARDS AND ACKNOWLEDGEMENTS**

ORS received the following recognitions:

- Certificate of Achievement for Excellence in Financial Reporting for our fiscal year 2006 *Comprehensive Annual Financial Report*. Awarded by the Government Finance Officers Association of the United States and Canada.
- Public Pension Standards 2007 Award for meeting standards for public retirement system management and administration. Awarded by the Public Pension Coordinating Council.
- Blue Pencil-Gold Screen Award for two online video tutorials produced in-house on the topics of earning and purchasing service credit. Awarded by the National Association of Government Communicators in the Shoestring Budget category.
- 2007 Outstanding Program Award for our reorganization and reengineering efforts as we transitioned to become a process-based organization. Awarded by the National Association of State Chief Administrators.
- Innovator Award for our introduction of a phone appointment process that provides high-quality counseling services with less travel time and cost. Awarded by the State of Michigan Department of Management and Budget.

# INTRODUCTORY SECTION

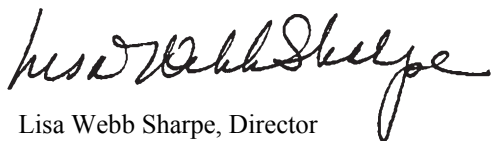
## Letter of Transmittal (Continued)

### *Acknowledgements*

The preparation of this report was accomplished with the dedication and cooperation of many people. It is intended to provide complete and reliable information as a basis for making management decisions, as a means of determining compliance with legal provisions, and as a means for determining responsible stewardship of the funds of the System.

We would, therefore, like to express our appreciation for the assistance given by staff, advisors and the many people who contributed to its preparation. We believe their combined efforts have produced a report that will enable employers and plan members to better evaluate and understand the Michigan State Police Retirement System. Their cooperation contributes significantly to the success of the System.

Sincerely,



Lisa Webb Sharpe, Director  
Department of Management and Budget



Phillip J. Stoddard, Director  
Office of Retirement Services

# INTRODUCTORY SECTION

## Administrative Organization

### **Retirement Board Members \***

Capt. Christopher Lewis  
Representing Director, Dept. of State  
Police  
Statutory Member

George M. Elworth  
Representing Attorney General  
Statutory Member

Sergeant Richard Hale, Chair  
Representing Sergeants and Below  
Term Expires December 31, 2009

Sally Corbin  
General Public  
Term Expires December 31, 2009

Scott Bowen  
Director, Office of State Employer  
Statutory Member

Craig Murray  
Representing Deputy Auditor General  
Statutory Member

Vernon Johnson  
Representing State Treasurer  
Statutory Member

Lieutenant Joseph Thomas  
Representing Lieutenants and Above  
Term Expires December 31, 2007

Diane Garrison  
Retiree Member  
Term Expires December 31, 2008

\* Statute provides that board members may continue to serve after their term expires until they are either replaced or reappointed.

### **Administrative Organization**

**Department of Management and Budget  
Office of Retirement Services  
P.O. Box 30171  
Lansing, Michigan 48909-7671  
517-322-5103  
1-800-381-5111**

### **Advisors and Consultants**

#### **Actuaries**

Gabriel Roeder Smith & Company  
Alan E. Sonnanstine  
Southfield, Michigan

#### **Auditors**

Thomas H. McTavish, C.P.A.  
Auditor General  
State of Michigan

#### **Investment Manager and Custodian**

Robert J. Kleine  
State Treasurer  
State of Michigan

Andrews Hooper & Pavlik P.L.C.  
Jeffrey J. Fineis, C.P.A.  
Okemos, Michigan

#### **Legal Advisor**

Mike Cox  
Attorney General  
State of Michigan

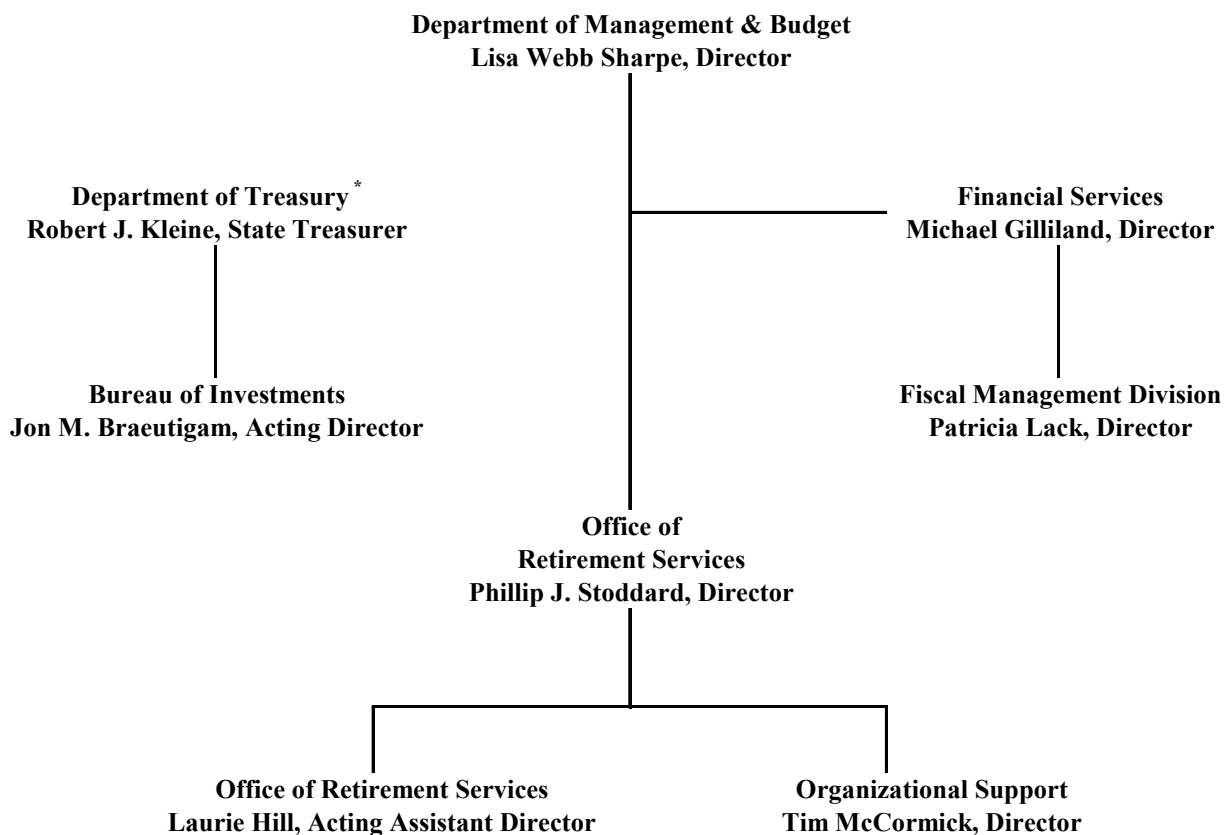
#### **Investment Performance Measurement**

State Street Corporation  
State Street Analytics  
Boston, MA

# INTRODUCTORY SECTION

## Administrative Organization (Continued)

### Organization Chart



\* The investments of the System are managed by the Michigan Department of Treasury. Information on the investments and the fiduciary, Michigan Department of Treasury, can be found in the Investment Section, Introduction. In addition, see the Investment Section, Schedule of Investment Fees and Schedule of Investment Commissions, for information regarding the investment fees and commissions paid as well as investment professionals utilized by the System.

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# FINANCIAL SECTION

Independent Auditor's Report  
Management's Discussion and Analysis  
Basic Financial Statements  
Notes to Basic Financial Statements  
Required Supplementary Information  
Notes to Required Supplementary Information  
Supporting Schedules

# FINANCIAL SECTION

## Independent Auditor's Report



**ANDREWS HOOPER & PAVLIK P.L.C.**  
Certified Public Accountants

Ms. Lisa Webb Sharpe, Director, Department of Management and Budget  
Mr. Phillip Stoddard, Director, Office of Retirement Services  
Mr. Thomas H. McTavish, CPA, Auditor General, Office of the Auditor General  
Michigan State Police Retirement System Board

We have audited the accompanying statements of pension plan and postemployment healthcare plan net assets of the Michigan State Police Retirement System, as of September 30, 2007 and 2006, and the related statements of changes in pension plan and postemployment healthcare plan net assets for the years then ended. These financial statements are the responsibility of the management of the Michigan State Police Retirement System. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial status of the Michigan State Police Retirement System, as of September 30, 2007 and 2006, and the changes in its financial status for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 14, 2007 on our consideration of the Michigan State Police Retirement System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.



## Independent Auditor's Report (Continued)

The Management's Discussion and Analysis (MD&A) is not a required part of the basic financial statements but is supplemental information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this required supplemental information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The Introductory, Investment, Actuarial, and Statistical Sections and the required supplementary information and supporting schedules listed in the table of contents are presented for the purposes of additional analysis and are not a required part of the basic financial statements. The Introductory, Investment, Actuarial, and Statistical Sections and the required supplementary information and supporting schedules are the responsibility of the Michigan State Police Retirement System's management. The Schedules of Funding Progress and Employer Contributions and related notes and the supporting schedules have been subjected to the auditing procedures applied in our audits of the basic financial statements, and in our opinion, are fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole. The Introductory, Investment, Actuarial, and Statistical Sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

*Andrews Hooper & Pavlik P.L.C.*

Okemos, Michigan  
December 14, 2007

# FINANCIAL SECTION

## **Management's Discussion and Analysis**

Our discussion and analysis of the Michigan State Police Retirement System's (System) financial performance provides an overview of the System's financial activities for the fiscal year ended September 30, 2007. Please read it in conjunction with the transmittal letter in the Introductory Section on page 6 and the basic financial statements, which follow this discussion.

### **FINANCIAL HIGHLIGHTS**

- System assets exceeded its liabilities at the close of fiscal year 2007 by \$1.3 billion (reported as *net assets*). Net assets are held in trust to meet future benefit payments.
- System funding objective is to meet long-term benefit obligations through contributions and investment income. As of September 30, 2006, the funded ratio was approximately 86.9% for pension benefits and the funded ratio for other postemployment benefits was 0.0%.
- Revenues for the year were \$255.1 million, which is comprised primarily of contributions of \$53.5 million and investment gains of \$201.6 million.
- Expenses increased over the prior year from \$112.3 million to \$114.4 million or 1.9%. Most of this increase represented increased retirement benefits paid.

### **THE STATEMENT OF PLAN NET ASSETS AND THE STATEMENT OF CHANGES IN PLAN NET ASSETS**

This Comprehensive Annual Financial Report (CAFR) consists of two financial statements; *The Statements of Pension Plan and Other Postemployment Plan Net Assets* (page 24) and *The Statements of Changes in Pension Plan and Other Postemployment Plan Net Assets* (page 25). These financial statements report information about the System, as a whole, and about its financial condition that should help answer the question: Is the System, as a whole, better off or worse off as a result of this year's activities? These statements include all assets and liabilities using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, all revenues and expenses are taken into account regardless of when cash is received or paid.

*The Statement of Pension Plan and Other Postemployment Plan Net Assets* presents all of the System's assets and liabilities, with the difference between the two reported as net assets. Over time, increases and decreases in net assets measure whether the System's financial position is improving or deteriorating. *The Statement of Changes in Pension Plan and Other Postemployment Plan Net Assets* presents how the System's net assets changed during the most recent fiscal year. These two financial statements should be reviewed along with the Schedules of Funding Progress (page 42) and Schedules of Employer Contributions (page 43) to determine whether the System is becoming financially stronger or weaker and to understand changes over time in the funded status of the System.

# FINANCIAL SECTION

## Management's Discussion and Analysis (Continued)

### FINANCIAL ANALYSIS

System total assets as of September 30, 2007, were \$1.6 billion and were mostly comprised of cash, investments and contributions due from employers. Total assets increased \$235.9 million or 16.9 % from fiscal year 2006, and increased \$204.8 million or 17.2% between fiscal years 2005 and 2006 primarily due to favorable operating results and increases to invested assets (primarily collateral on loaned securities).

Total liabilities as of September 30, 2007, were \$282.9 million and were mostly comprised of warrants outstanding, accounts payable, and obligations under securities lending. Total liabilities increased \$95.1 million or 50.7% between fiscal years 2006 and 2007, and increased \$123.9 million or 193.8% between fiscal years 2006 and 2005, primarily due to an increase in obligations under securities lending.

System assets exceeded its liabilities at the close of fiscal year 2007 by \$1.3 billion. Total net assets held in trust for pension and health benefits increased \$140.8 million or 11.7% between fiscal years 2006 and 2007. The increase is the result of favorable operating results primarily due to investment earnings and contributions for the year exceeding total deductions to System net assets. Net assets in fiscal year 2006 increased by \$80.9 million or 7.2% from the prior year due to favorable operating results primarily due to investment earnings and contributions for the year exceeding total deductions to System net assets.

#### Net Assets (in thousands)

	2007	Increase (Decrease)		2006	Increase (Decrease)		2005
<b>Assets</b>							
Cash	\$ 5,009	23.3 %	\$	4,064	4.5 %	\$	3,890
Receivables	2,516	(18.6)		3,090	10.8		2,790
Investments	1,620,354	17.0		1,384,848	17.3		1,180,557
<b>Total Assets</b>	<u>1,627,879</u>	<u>16.9</u>		<u>1,392,002</u>	<u>17.2</u>		<u>1,187,237</u>
<b>Liabilities</b>							
Warrants outstanding	195	(5.3)		206	47.1		140
Accounts payable and other accrued liabilities	87	(13.0)		100	(2.9)		103
Obligations under securities lending	282,597	50.8		187,448	194.5		63,653
<b>Total Liabilities</b>	<u>282,879</u>	<u>50.7</u>		<u>187,754</u>	<u>193.8</u>		<u>63,896</u>
<b>Total Net Assets</b>	<u>\$ 1,345,000</u>	<u>11.7 %</u>	<u>\$</u>	<u>1,204,248</u>	<u>7.2 %</u>	<u>\$</u>	<u>1,123,341</u>

# **FINANCIAL SECTION**

## **Management's Discussion and Analysis (Continued)**

### **REVENUES - ADDITIONS TO PLAN NET ASSETS**

The reserves needed to finance retirement and health benefits are accumulated through the collection of employer contributions and through earnings on investments. Contributions and net investment income/(losses) for fiscal year 2007 totaled \$255.1 million.

Total additions increased \$61.9 million from those of fiscal year 2006, due primarily to increased investment earnings. Total additions increased \$5.3 million between fiscal years 2005 and 2006 due primarily to increased investment earnings. Total contributions increased between fiscal years 2006 and 2007 by \$0.9 million or 1.6%. This increase is primarily due to an increase in the contribution rate. Total contributions decreased between fiscal years 2005 and 2006 by \$4.1 million or (7.3)% primarily due to a decrease in the contribution rate. Investment income increased from fiscal year 2006 by \$61.0 million. Investment income increased between fiscal years 2005 and 2006 by \$9.5 million. The Investment Section of this report reviews the results of investment activity for 2007.

### **EXPENSES - DEDUCTIONS FROM PLAN NET ASSETS**

The primary expenses of the System include the payment of pension benefits to members and beneficiaries, payment for health, dental and vision benefits, refund of contributions to former members, and the cost of administering the System. Total deductions for fiscal year 2007 were \$114.4 million, an increase of 1.9% over fiscal year 2006 expenses.

The health, dental and vision care expenses decreased during the year by \$0.4 million or (1.5)% from \$29.5 million to \$29.1 million during the fiscal year. This compares to an increase of \$2.7 million or 9.9% from \$26.8 million to \$29.5 million between fiscal years 2005 and 2006. The payment of pension benefits increased by \$2.6 million or 3.2% between fiscal years 2006 and 2007, and by \$2.1 million or 2.7% between fiscal years 2005 and 2006. The increase in pension benefit expenses in 2007 resulted from an increase in retirees (23). In fiscal year 2006, the increase in pension benefit expenses resulted from a decrease in retirees (15) and an increase in the benefits paid to retirees. Administrative expenses increased by \$58,365 or 17.1% between fiscal years 2006 and 2007, primarily due to an increase in professional services during the current year for special actuarial services. Administrative expenses increased by \$49,022 or 16.7% between fiscal years 2005 and 2006, primarily due to an increase in professional services and an increase in technological support.

# FINANCIAL SECTION

## Management's Discussion and Analysis (Continued)

### Changes in Plan Net Assets (in thousands)

	<u>2007</u>	<u>Increase (Decrease)</u>		<u>2006</u>	<u>Increase (Decrease)</u>		<u>2005</u>
Member contributions	\$ 1,321	(12.3) %	\$	1,507	(10.2) %	\$	1,679
Employer contributions	52,163	2.0		51,125	(7.2)		55,096
Net investment income	201,614	43.4		140,566	7.2		131,111
Miscellaneous income	47	-		4	-		-
<b>Total Additions</b>	<u>255,145</u>	<u>32.1</u>		<u>193,202</u>	<u>2.8</u>		<u>187,886</u>
Pension benefits	84,930	3.2		82,317	2.7		80,170
Health Care benefits	29,060	(1.5)		29,493	9.9		26,842
Refunds of member contributions	1	(99.2)		143	(100.0)		-
Administrative expenses	402	17.1		343	16.7		294
<b>Total Deductions</b>	<u>114,393</u>	<u>1.9</u>		<u>112,296</u>	<u>4.7</u>		<u>107,306</u>
<b>Net Increase</b>	140,752	74.0		80,906	0.4		80,580
<b>Net Assets - Beginning of Year</b>	<u>1,204,248</u>	<u>7.2</u>		<u>1,123,342</u>	<u>7.7</u>		<u>1,042,762</u>
<b>Net Assets - End of Year</b>	<u>\$ 1,345,000</u>	<u>11.7 %</u>	<u>\$</u>	<u>1,204,248</u>	<u>7.2 %</u>	<u>\$</u>	<u>1,123,342</u>

# ***FINANCIAL SECTION***

## **Management's Discussion and Analysis (Continued)**

### **RETIREMENT SYSTEM AS A WHOLE**

The System's combined net assets experienced an increase for the fifth consecutive year. This increase is a result of a moderate national economic upturn that resulted in improved investment income earnings. Management believes, and actuarial studies concur, that the System is in a financial position to meet its current obligations. We believe the current financial position has improved, in part, due to a prudent investment program, cost controls, and strategic planning.

### **CONTACTING SYSTEM FINANCIAL MANAGEMENT**

This financial report is designed to provide the Retirement Board, our membership, taxpayers, investors, and creditors with a general overview of the System's finances and to demonstrate the System's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the Office of Retirement Services, P.O. Box 30171, Lansing, MI 48909-7671.

## ***FINANCIAL SECTION***

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# FINANCIAL SECTION

## Statements of Pension Plan and Other Postemployment Plan Net Assets

As of September 30, 2007 and 2006

	September 30, 2007			September 30, 2006		
	Pension Plan	OPEB Plan	Total	Pension Plan	OPEB Plan	Total
<b>Assets:</b>						
Equity in common cash	\$ 5,009,460		\$ 5,009,460	\$ 4,063,767		\$ 4,063,767
Receivables:						
Amounts due						
from employer	2,432,195		2,432,195	3,056,390		3,056,390
Interest and dividends	83,689		83,689	33,698		33,698
Total receivables	2,515,884	-	2,515,884	3,090,088	-	3,090,088
Investments:						
Short term investment pools	20,652,265		20,652,265	21,843,600		21,843,600
Fixed income pools	218,636,688		218,636,688	192,055,307		192,055,307
Domestic equity pools	627,788,771		627,788,771	582,758,980		582,758,980
Real estate pool	130,416,859		130,416,859	100,633,124		100,633,124
Alternative investment pools	188,050,550		188,050,550	152,186,251		152,186,251
International equities pools	152,211,843		152,211,843	147,922,103		147,922,103
Cash collateral on loaned securities	282,596,545		282,596,545	187,448,116		187,448,116
Total investments	1,620,353,521	-	1,620,353,521	1,384,847,481	-	1,384,847,481
<b>Total assets</b>	<b>1,627,878,865</b>	<b>-</b>	<b>1,627,878,865</b>	<b>1,392,001,336</b>	<b>-</b>	<b>1,392,001,336</b>
<b>Liabilities:</b>						
Warrants outstanding	194,863		194,863	205,957		205,957
Accounts payable and other accrued liabilities	87,373		87,373	99,596		99,596
Obligations under securities lending	282,596,545		282,596,545	187,448,116		187,448,116
<b>Total liabilities</b>	<b>282,878,781</b>	<b>-</b>	<b>282,878,781</b>	<b>187,753,669</b>	<b>-</b>	<b>187,753,669</b>
<b>Net Assets Held in Trust for Pension and OPEB Benefits*</b>	<b>\$ 1,345,000,084</b>	<b>\$ -</b>	<b>\$ 1,345,000,084</b>	<b>\$ 1,204,247,667</b>	<b>\$ -</b>	<b>\$ 1,204,247,667</b>

\*A schedule of funding progress is presented in the Required Supplementary Information of the Financial Section.

The accompanying notes are an integral part of these financial statements.



# FINANCIAL SECTION

## Statements of Changes in Pension Plan and Other Postemployment Plan Net Assets

For Fiscal Years Ended September 30, 2007 and 2006

	September 30, 2007			September 30, 2006		
	Pension Plan	OPEB Plan	Total	Pension Plan	OPEB Plan	Total
<b>Additions:</b>						
Contributions:						
Member contributions	\$ 101,205	\$ 1,219,760	\$ 1,320,965	\$ 252,805	\$ 1,254,352	\$ 1,507,157
Employer contributions	24,323,324	27,840,439	52,163,763	26,103,923	25,021,287	51,125,210
Total contributions	24,424,529	29,060,199	53,484,728	26,356,728	26,275,639	52,632,367
Investment income (loss):						
Net appreciation (depreciation) in						
fair value of investments	175,536,957		175,536,957	113,988,819		113,988,819
Interest, dividends, and other	27,449,950		27,449,950	27,976,618		27,976,618
Investment expenses:						
Real estate operating expenses	(30,481)		(30,481)	(10,033)		(10,033)
Other investment expenses	(1,864,357)		(1,864,357)	(1,554,930)		(1,554,930)
Securities lending activities:						
Securities lending income	12,898,813		12,898,813	4,389,349		4,389,349
Securities lending expenses	(12,376,851)		(12,376,851)	(4,224,292)		(4,224,292)
Net investment income (loss)	201,614,031	-	201,614,031	140,565,531	-	140,565,531
Miscellaneous income	46,558	-	46,558	6	4,319	4,325
<b>Total additions</b>	<b>226,085,118</b>	<b>29,060,199</b>	<b>255,145,317</b>	<b>166,922,265</b>	<b>26,279,958</b>	<b>193,202,223</b>
<b>Deductions:</b>						
Benefits paid to plan members						
and beneficiaries:						
Retirement benefits	84,930,044		84,930,044	82,316,931		82,316,931
Health benefits		26,675,560	26,675,560		27,090,226	27,090,226
Dental/vision benefits		2,384,639	2,384,639		2,402,514	2,402,514
Refunds of						
member contributions	1,087		1,087	142,979		142,979
Administrative expenses	401,570		401,570	343,205		343,205
<b>Total deductions</b>	<b>85,332,701</b>	<b>29,060,199</b>	<b>114,392,900</b>	<b>82,803,115</b>	<b>29,492,740</b>	<b>112,295,855</b>
<b>Net Increase (Decrease)</b>	<b>140,752,417</b>	<b>-</b>	<b>140,752,417</b>	<b>84,119,150</b>	<b>(3,212,782)</b>	<b>80,906,368</b>
<b>Net Assets Held in Trust</b>						
<b>for Pension and</b>						
<b>OPEB Benefits:</b>						
<b>Beginning of Year</b>	<b>1,204,247,667</b>	<b>-</b>	<b>1,204,247,667</b>	<b>1,120,128,517</b>	<b>3,212,782</b>	<b>1,123,341,299</b>
<b>End of Year*</b>	<b>\$ 1,345,000,084</b>	<b>\$ -</b>	<b>\$ 1,345,000,084</b>	<b>\$ 1,204,247,667</b>	<b>\$ -</b>	<b>\$ 1,204,247,667</b>

\* A schedule of funding progress is presented in the Required Supplementary Information of the Financial Section.

The accompanying notes are an integral part of these financial statements.

# FINANCIAL SECTION

## Notes to Basic Financial Statements

### NOTE 1 - PLAN DESCRIPTION

#### ORGANIZATION

The Michigan State Police Retirement System (System) is a single employer, state-wide, defined benefit public employee retirement plan governed by the State of Michigan (State), originally created under Public Act 251 of 1935, recodified and currently operating under Public Act 182 of 1986. Section 7 of this act establishes the board's authority to promulgate or amend the provisions of the System. The System was established by the State to provide retirement, survivor and disability benefits to Michigan State Police. In addition, the System's health plan provides all retirees with the option of receiving health, dental, and vision coverage under the State Police Retirement Act. The System is a qualified pension trust fund under section 401(a) of the Internal Revenue Code.

The System's financial statements are included as a pension trust fund in the combined financial statements of the State.

The System is administered by the Office of Retirement Services within the Michigan Department of Management and Budget. The Department Director appoints the Office Director who serves as Executive Secretary to the System's Board, with whom the general oversight of the System resides. The State Treasurer serves as the investment officer and custodian for the System.

#### MEMBERSHIP

At September 30, 2007, and 2006, the System's membership consisted of the following:

Retirees and beneficiaries		
currently receiving benefits:	<b>2007</b>	<b>2006 *</b>
Regular benefits	2,150	2,152
Survivor benefits	422	410
Disability benefits	163	150
<b>Total</b>	<b>2,735</b>	<b>2,712</b>
Current employees:		
Vested	1,123	1,094
Non-vested	497	584
<b>Total</b>	<b>1,620</b>	<b>1,678</b>
DROP program participants	148	129
Inactive employees entitled to benefits and not yet receiving them	15	12
<b>Total members</b>	<b>4,518</b>	<b>4,531</b>

Enrollment in the health plan is voluntary. The number of participants is as follows:

<b>Health, Dental, and Vision Plans</b>	<b>2007</b>	<b>2006 *</b>
Eligible participants	2,735	2,712
Participants receiving benefits:		
Health	2,431	2,411
Dental	2,416	2,394
Vision	2,421	2,399

\* Restated based on more complete information provided by the actuary.

# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

### BENEFIT PROVISIONS -- PENSION

#### *Introduction*

Benefit provisions of the defined benefit pension plan are established by State statute, which may be amended. Public Act 182 of 1986, Michigan State Police Retirement Act, as amended, establishes eligibility and benefit provisions for the defined benefit pension plan. Retirement benefits are determined by final average compensation. Members are eligible to receive a monthly benefit when they meet certain age and service requirements. The System also provides duty disability, non-duty disability, and survivor benefits.

A member who leaves Michigan State Police employment may request a refund of his or her member contribution account. The System is currently non-contributory. A refund cancels a former member's rights to future benefits and there is no provision for repaying the refund of contributions to restore the service represented by the refund.

#### *Regular Retirement*

The retirement benefit is available if a member retires after 25 years of credited service (employment). The retirement benefit equals 60% of a member's final average compensation and is payable monthly over the lifetime of a member. Final average compensation is the average annual salary for a member's last two years of service with the Department of State Police.

#### *Deferred Retirement*

Any member with 10 or more years of credited service who terminates employment but has not reached the age of 50 is a deferred member and is entitled to receive a monthly allowance upon reaching age 50, provided the member's accumulated contributions have not been refunded. The deferred benefit is equal to two percent of the final average compensation times the years and partial years of service credit.

#### *Non-Duty Disability Benefit*

A member with 10 or more years of credited service who becomes totally and permanently disabled not due to performing duties as an employee of the Michigan State Police is eligible for a non-duty disability pension. The non-duty disability benefit is 2.4% of the final average compensation times years and partial years of credited service (but not more than 25 years).

#### *Duty Disability Benefit*

A member who becomes totally and permanently disabled from performing duties as a Michigan State Police Officer is eligible for a duty disability pension. The amount, payable monthly, is equal to 60% of the final average compensation.

#### *Survivor Benefit*

Upon the death of a member who completed at least 10 years of service, the surviving spouse receives a benefit based on 2.4% of the final average compensation for each year and partial years of credited service. If there is no spouse, surviving children are entitled to equally share the benefit until age 18. If death occurs in the line of duty, the surviving spouse receives a benefit of 60% of the final average compensation. Children receive \$100 each month until age 18. A \$1,500 funeral expense is also authorized by State statute.

#### *Post Retirement Adjustments*

Effective October 1, 1996, the monthly pension was increased 10% if certain requirements were met. This was a one time increase.

Each October 1, the benefits of all pension recipients increase 2% (not to exceed \$500). This non-compounding increase is paid to persons who have been retired 12 months.

# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

### *Contributions*

Member Contributions — Members currently participate on a noncontributory basis. Under certain circumstances, members may contribute to the System for the purchase of creditable service, such as military, maternity or paternity leave, Peace Corps or VISTA service. If a member terminates employment before a retirement benefit is payable, the member's contribution and interest on deposit are refunded. If the member dies before being vested, the member's contribution and interest are refunded to the designated beneficiaries.

Employer Contributions — The statute requires that the employer contribute to finance the benefits of plan members. These employer contributions are determined annually by the System's actuary and are based upon level-percent-of-payroll funding principles so that the contribution rates do not have to increase over time. A chart showing the employer contribution rates is included on the Schedule of Revenues by Source in the Statistical Section.

### *Deferred Retirement Option Plan*

Public Act 83 of 2004 amended the State Police Retirement Act to create a Deferred Retirement Option Plan (DROP) for members with 25 years of service. This benefit program allows state police who are eligible to retire to defer their retirement and keep working for up to six years. The participant's pension amount is calculated on the day before the DROP period starts, and a percentage of the equivalent monthly pension is credited to an interest-bearing account in the participant's name. The DROP balance will be available at the time their DROP participation ends.

### *Banked Leave Time*

Public Act 50 of 2004 amended the State Police Retirement Act to include Banked Leave Time (BLT) for members. BLT is an extension of the State's current annual leave program, which banks a predetermined number of hours per pay period. However, the BLT program will not have an effect on a member's Final Average Compensation calculation.

## **BENEFIT PROVISIONS – OTHER POSTEMPLOYMENT**

### *Introduction*

Benefit provisions of the postemployment healthcare plan are established by State statute, which may be amended. Public Act 182 of 1986, as amended, establishes eligibility and benefit provisions for the health plan. Members are eligible to receive health, prescription drug, dental, and vision coverage on the first day they start receiving pension benefits. There are no ad hoc or automatic increases. The State Police Retirement Act requires joint authorization by DMB and the Civil Service Commission to make changes to retiree medical benefit plans.

Under the Michigan State Police Retirement Act, all retirees have the option of continuing health, dental, and vision coverage. Retirees with this coverage contribute 5%, 10%, and 10% of the monthly premium amount for the health, dental, and vision coverage, respectively. The State funds 95% of the health and 90% of the dental and vision insurance. The employer payroll contribution rate to provide these benefits was 23.0% and 21.0% for 2007 and 2006, respectively.

The State Health Plan PPO is by far the most often selected health care option. This plan includes comprehensive coverage traditionally referred to as basic and major medical, with full coverage for most services received in-network after an annual deductible is met. Preventive services are not subject to a deductible and are fully covered if received in-network subject to an annual maximum. Both retail and mail order prescription drug coverage is included. Retiree health, dental, and vision plan benefits have generally matched those in place for active employees.

Retirees are also provided with life insurance coverage equal to 25% of the active life insurance coverage, \$1,000 for spouse and \$1,000 for each dependent under the age of 23. Premiums are fully paid by the State.

# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

The number of participants and other relevant financial information are as follows:

<b>Health, Dental, and Vision Plans</b>	<b>2007</b>	<b>2006</b>
Eligible participants	2,735	2,712
Participants receiving benefits:		
Health	2,431	2,411
Dental	2,416	2,394
Vision	2,421	2,399
Expenses for the year	\$ 29,060,199	\$ 29,492,740
Employer payroll contribution rate	23.0%	21.0%

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### *Basis of Accounting and Presentation*

Financial statements are prepared using the accrual basis of accounting. Contributions from the State are recognized as revenue when due and payable. Benefits and refunds are recognized when due and payable in accordance with the terms of the System.

### *Reserves*

Public Act 182 of 1986, as amended, created the Reserve for Employee Contributions, Reserve for Retired Benefit Payments, Reserve for Employer Contributions, Reserve for Undistributed Investment Income, and Reserve for Health (OPEB) Related Benefits. The financial transactions of the System are recorded in these accounts as required by Public Act 182 of 1986, as amended.

Reserve for Employee Contributions — Members do not contribute to this reserve except to purchase eligible service credit. This reserve represents active member contributions and interest less amounts transferred to the Pension Reserve for regular and disability retirement, amounts refunded to terminated members, and unclaimed amounts transferred to the income account. At September 30, 2007, and 2006, the balance in this account was \$651.7 thousand and \$553.6 thousand, respectively.

Reserve for Employer Contributions — All employer contributions are credited to this reserve. Interest from the Reserve for Undistributed Investment Income is credited annually. Amounts are transferred annually from this reserve to the Reserve for Retired Benefit Payments to fund that reserve. At September 30, 2007, and 2006, the balance in this account was \$20.4 million and \$69.4 million, respectively.

Reserve for Retired Benefit Payments — This represents the reserves for payment of future retirement benefits to persons already on the retirement rolls. At retirement, a member's accumulated contributions plus interest are transferred into this reserve from the Reserve for Employee Contributions. Monthly benefits, which are paid to the retirees, reduce this reserve. At the end of each fiscal year, an amount is transferred from the Reserve for Employer Contributions to bring the reserve into balance with the actuarial present value of retirement allowances. Also included are reserves for casualty experience (injury or death of a member, or vested former member). The initial actuarial casualty valuation determined the full funding reserve requirements to be allocated from assets of the reserve. All retiree casualty payments are made from this account. At September 30, 2007, and 2006, the balance in this account was \$969.3 million and \$903.1 million, respectively.

Reserve for Undistributed Investment Income — The reserve is credited with all investment earnings and changes in fair value of assets. Interest is transferred annually to the other reserves. Administrative expenses are paid from this reserve account. The legislature appropriates the funds necessary to defray and cover the administration of the plan. At September 30, 2007, and 2006, the balance of this reserve was \$354.7 million and \$231.3 million, respectively.

# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

**Reserve for Health (OPEB) Related Benefits** — This reserve is credited with employer contributions for retirees' health benefits. The required contribution is based on pay-as-you-go funding. It represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liability (or funding excess) over a period not to exceed thirty years. From this reserve, the System pays 95% of the premiums for hospitalization and medical coverage insurance and 90% of the monthly premium for dental and vision coverage insurance. At September 30, 2007, and 2006, the balance in this account was \$0.0 million.

Section 204 of Public Act 431 of 1984, as amended, provides management the ability to administer selected risk management related programs for insurance or related services. If the Reserve for Health Related Benefits expenses exceed revenues, the State Sponsored Group Insurance Fund, which bears the risk of such losses, will return excess premiums to the System to make the Reserve whole. This is reflected in the Statement of Changes in Pension Plan Net Assets as an employer contribution to the Health Plan. In fiscal year 2007 the expenses exceeded revenues by \$1.2 million prior to a return of \$1.2 million to the System.

### ***Reporting Entity***

The System is a pension trust fund of the State. As such, the System is considered part of the State and is included in the State's Comprehensive Annual Financial Report as a pension trust fund. The System and its Board are not financially accountable for any other entities or other organizations. Accordingly, the System is the only entity included in this financial report.

### ***Benefit Protection***

Public Act 100 of 2002 was passed by the Michigan Legislature to protect pension benefits of public employees from alienation (being transferred). Alienation is attachment, garnishment, levy, execution, bankruptcy or other legal process except for divorce orders or eligible domestic relation orders. The statutes governing the System contained an "anti-alienation" clause to provide for this protection; however, many smaller public pension systems did not have the benefit of this protection. Therefore, Public Act 100 of 2002 was passed to establish legal protection of pension assets that encompasses all public employees.

### ***Fair Value of Investments***

Plan investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Corporate bonds not traded on a national or international exchange are based on equivalent values of comparable securities with similar yield and risk. Real estate debt is valued on the basis of future principal and interest payments, and is discounted at prevailing interest rates for similar instruments. The fair value of real estate investments is based on independent appraisals. Other investments not having an established market are recorded at estimated fair value.

### ***Investment Income***

Dividend and interest income is recognized on the accrual basis. Fair value changes are recorded as investment income or loss. Purchases and sales of investments are recorded as of the trade date (the date upon which the transaction is initiated), except for purchase and sale of mortgages, real estate, and alternative investments, which are recorded as of the settlement date (the date upon which the transaction is ultimately completed). The effect of recording such transactions as of the settlement date does not materially affect the financial statements.

### ***Costs of Administering the System***

Each year a restricted general fund appropriation is requested to fund the on-going business operations of the System. These administrative costs are ultimately funded by the System through the regular transfer of funds from the System to the State's general fund based on either a direct cost or allocation basis depending on the nature of the expense. Costs of administering the System are financed by undistributed investment income of the System.

# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

### *Property and Equipment*

Office space is leased from the State on a year to year basis. Office equipment is capitalized if the value exceeds \$5,000. These assets are recorded at cost and are reported net of depreciation in the Statement of Pension Plan and Postemployment Healthcare Plan Net Assets. Such assets are depreciated on a straight-line basis over 10 years. The System does not have equipment that falls within these parameters.

### *Related Party Transactions*

Leases and Services — The System leases operating space and purchases certain administrative, data processing, legal and investment services from the State. The space and services are not otherwise available by competitive bid. The following summarizes costs incurred by the System for such services.

	<u>2007</u>	<u>2006</u>
Building Rentals	\$ 7,395	\$ 5,631
Technological Support	85,935	76,203
Attorney General	37,245	28,386
Investment Services	240,125	225,515
Personnel Services	84,383	82,643

Commitment and Contingency — The State has signed a contract with a vendor for technological support through 2007. As of September 30, 2007, the System's portion of this commitment is approximately \$15,783.

Cash — On September 30, 2007, and 2006, the System had \$5.0 million and \$4.1 million, respectively in a common cash investment pool maintained for various State operating funds. The participating funds in the common cash pool earn interest at various rates depending upon prevailing short-term interest rates. Earnings from these activities amounted to \$99,430 and \$100,086 for the years ended September 30, 2007, and 2006, respectively.

### *Reclassification of Prior Year Amounts*

Certain prior year amounts have been reclassified to conform with the current year presentation.

## NOTE 3 – CONTRIBUTIONS AND FUNDED STATUS

### *Contributions*

Members currently participate in the System on a noncontributory basis. Under certain circumstances, members may contribute to the System for the purchase of creditable service, such as military service or maternity leave. The State is required by Public Act 182 of 1986, as amended, to contribute amounts necessary to finance the benefits of its employees and retiree health benefits. Contribution provisions are specified by State statute and may be amended only by action of the State Legislature.

Periodic employer contributions to the System are determined on an actuarial basis using the entry age normal actuarial cost method. Under this method, the actuarial present value of the projected benefits of each individual included in the actuarial valuation is allocated on a level basis over the service of the individual between entry age and assumed exit age. The portion of this cost allocated to the current valuation year is called the normal cost. The remainder is called the actuarial accrued liability. Normal cost is funded on a current basis. For retirement benefits, the unfunded (overfunded) actuarial accrued liability is amortized over a 29-year period for the 2007 fiscal year and a 30-year period for the 2006 fiscal year. For health benefits, the unfunded (overfunded) actuarial accrued liability is amortized over a maximum period of 30 years. Because this is the first year of reporting for other post-employment benefits (OPEB), comparative data is not yet available. GASB Statement No. 43 does not require retroactive presentation.

# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

Actual employer contributions for retirement benefits were \$24.3 million and \$26.1 million for fiscal years 2007 and 2006, respectively, representing 22.5% of annual covered payroll for the year ended September 30, 2006. The fiscal year 2007 annual covered payroll is not yet available. Required employer contributions, based on previous year actuarial valuations, for pensions included:

1. \$21.5 million and \$23.9 million for fiscal years 2007 and 2006, respectively, for the normal cost of pensions representing 18.5% and 20.3% (before reconciliation) of annual covered payroll for fiscal years 2006 and 2005, respectively.
2. \$10.9 million and \$12.2 million for fiscal years 2007 and 2006, respectively, for amortization of underfunded actuarial accrued liability representing 9.4% and 10.4% (before reconciliation) of annual covered payroll for fiscal years 2006 and 2005, respectively.

Actual employer contributions for OPEB were \$27.8 million for fiscal year 2007. Required employer contributions based on previous actuarial valuations, for OPEB included:

1. \$25.3 million for fiscal year 2007 for the normal cost of OPEB representing 21.8% (before reconciliation) of annual covered payroll for fiscal year 2006.
2. \$34.4 million for fiscal year 2007 for amortization of unfunded actuarial accrued liability representing 29.7% (before reconciliation) of annual covered payroll for fiscal year 2006.

The system is required to reconcile with actuarial requirements annually. Any funding excess or deficiency for pension benefits is smoothed over five years. One fifth (20%) of the funding excess or deficiency is included in the subsequent years' contribution, and is not recognized as a payable or receivable in the accounting records.

In March of 2007, the Governor signed Executive Order 2007-3 as a means to reduce expenditures due to an anticipated revenue shortfall for the State for fiscal year 2007. Executive order 2007-3 authorized a reduction in contributions to the System through rate reductions, taking advantage of investment gains over the past few years, while still meeting the minimum contribution requirements for this fiscal year. Through this measure, the savings to the State totaled approximately \$8.2 million. These savings offset an equal amount of pension obligation that the State agency would have otherwise paid.

### ***Funded Status***

The employer is required to contribute at an actuarially determined rate for both pension benefits and OPEB. For fiscal year 2006, the actuarial accrued liability (AAL) for pension benefits was \$1.4 billion, and the actuarial value of assets was \$1.2 billion, resulting in an unfunded actuarial accrued liability (UUAL) of \$181.7 million and a funded ratio of 86.9%. The covered payroll (annual payroll of active employees covered by the plan) was \$115.9 million, and the ratio of the UAAL to the covered payroll was 156.8%.

For fiscal year 2006, the actuarial accrued liability (AAL) for OPEB was \$944.4 million, and the actuarial value of assets was \$0, resulting in an unfunded actuarial accrued liability (UAAL) of \$944.4 million and a funded ratio of 0.0%. The covered payroll (annual payroll of active employees covered by the plan) was \$115.9 million, and the ratio of the UAAL to the covered payroll was 814.9%.

### ***Actuarial Valuations and Assumptions***

Actuarial valuations for both the pension and OPEB plans involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions (ARC) are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets for both pension and OPEB plans is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.



# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

The accompanying schedules of employer contributions present trend information about the amounts contributed to the plan by employers in comparison to the ARC, an amount that is actuarially determined in accordance with the parameters of GASB Statement No. 25 for pension contributions and GASB Statement No. 43 for health contributions.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan member to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuation follows:

Valuation Date	9/30/2006
Actuarial Cost Method	Entry Age, Normal
Amortization Method	Level Percent of Payroll, Closed
Remaining Amortization Period	30 years <sup>(1)</sup>
Asset Valuation Method	5-Year Smoothed Market <sup>(2)</sup>
Actuarial Assumptions:	
Wage Inflation Rate	3.5%
Investment Rate of Return--Pension	8%
Investment Rate of Return--OPEB	4%
Projected Salary Increases	3.5% - 93.5%
Cost-of-Living Adjustments	2% Annual Non-Compounded with Maximum Annual Increase of \$500 for those eligible
Healthcare Cost Trend Rate	10% Year graded to 3.5% Year 12

<sup>(1)</sup> Based on the provisions of GASB Statement No. 25, when the actuarial accrued liability for a defined benefit pension plan is under funded or over funded, the difference should be amortized over a period not to exceed thirty years for the fiscal periods beginning on or after June 15, 2006.

<sup>(2)</sup> The actuarial value of assets was written up to the market value as of September 30, 2006. Beginning October 1, 2006, a 5-year smoothed market value will again be developed.

## NOTE 4 - INVESTMENTS

### *Investment Authority*

Under Public Act 380 of 1965, as amended, the authority for the purchase and the sale of investments resides with the State Treasurer. Investments are made subject to the Michigan Public Pension Investment Act, Public Act 314 of 1965, as amended. The Michigan Public Pension Investment Act authorizes, with certain restrictions, the investment of pension fund assets in stocks, corporate and government bonds and notes, mortgages, real estate, and certain short-term and alternative investments. Investments must be made for the exclusive purposes of providing benefits to active members, retired members and beneficiaries, and for defraying the expenses of investing the assets.

Under Public Act 314 of 1965, as amended, the State Treasurer may invest up to 5% of the System's assets in small businesses having more than one-half of assets or employees in Michigan as described in section 20(a) of the Act and up to 20% of the System's assets in investments not otherwise qualified under the Act as described in section 20(d). Alternative investments include limited partnerships and distributions from these partnerships in the form of bonds, preferred stock, common stock and direct investments.

# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

### *Derivatives*

The State Treasurer employs the use of derivatives in the investment of the pension trust funds.

Derivatives are used in managing pension trust fund portfolios, but uses do not include speculation or leverage of investments. Less than 12.0% of the total pension trust fund's portfolio has been invested from time to time in futures contracts, collateralized mortgages, swap agreements, and option contracts. State investment statutes limit total derivative exposure to 15.0% of a fund's total asset value, and restrict uses to replication of returns and hedging of assets. Swap agreements represent the largest category of derivatives used, and they represented 6.6% of market value of total pooled assets on September 30, 2007 and 9.1% of market value of total pooled assets on September 30, 2006. Futures contracts represent the second largest category of reported derivatives used, and they represented 0.2% of market value of total pooled assets on September 30, 2007, and 0.0% of market value of total pooled assets on September 30, 2006. Option contracts represent the third largest category of derivatives used, and they represented 0.0% of market value of total pooled assets on September 30, 2007, and 0.6% of market value of total pooled assets on September 30, 2006.

To enhance management flexibility, the State Treasurer has purchased futures contracts tied to Bond indices and Standard and Poor's indices. The bond futures contracts are combined with the rest of the fixed income investments to manage interest rate risk. Standard and Poor's futures contracts are combined with short-term investments or with the underlying stock to replicate or enhance the return of the Standard and Poor's indices.

To capitalize on shorter-term windows of investment opportunities, the State Treasurer has traded option contracts. Options allow more flexibility in achieving investment goals without disturbing the return/risk profiles of the longer-term strategies of the underlying investments.

To diversify the pension fund's portfolio, the State Treasurer has entered into swap agreements with investment grade counterparties, which are tied to stock market indices in the United States and twenty-two foreign countries. The notional amounts of the swap agreements at September 30, 2007, and 2006, were \$67.8 million and \$79.9 million, respectively. Approximately one half of the notional amount tied to foreign stock market indices is hedged against foreign currency fluctuations. The swap agreements provide that the Retirement System will pay quarterly, over the term of the swap agreements, interest indexed to the three month London Inter Bank Offer Rate (LIBOR), adjusted for an interest rate spread, on the notional amount stated in the agreements. At the maturity of the swap agreements, the pension fund will either receive the increase in the value of the equity indices from the level at the inception of the agreements, or pay the decrease in the value of the indices. Swap agreement maturity dates range from October 2007 to September 2010.

U.S. domestic LIBOR based floating rate notes and other investments earning short-term interest are held to correspond with the notional amount of the swap agreements. The State Treasurer maintains custody and control of these dedicated notes and short-term investments.

The value of these synthetic equity structures is a combination of the value of the swap agreements and the value of the notes and short-term investments. The book value represents the cost of the notes and short-term investments. The current value represents the current value of the notes and short-term investments and the change in value of the underlying indices from the inception of the swap agreements. The current value is used as a representation of the fair value based on the intention to hold all swap agreements until maturity. For fiscal years ending September 30, 2007, and 2006, international and domestic equity investment programs involving swaps, received realized gains and earned interest income of \$27.3 million and \$18.0 million, respectively.

The unrealized gains of \$21.0 million at September 30, 2007, and \$30.0 million at September 30, 2006, primarily reflects the increase in international stock indices and changes in currency exchange rates. The combined swap structure generally realizes gains and losses on a rolling three year basis.

# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

The respective September 30, 2007, and 2006 swap values are as follows:

	<u>Notional Value</u>	<u>Current Value</u>
9/30/07 (dollars in millions)	\$ 67.8	\$ 88.7
9/30/06 (dollars in millions)	79.9	109.8

The September 30, 2006, amounts shown above reflect both the total International Equity Pool swap exposure, and the smaller swap exposure to the Standard and Poor's Small Cap Index Pool. Swap contracts in the Standard and Poor's Small Cap Index Pool matured during the year ending September 30, 2007. Therefore the September 30, 2007, amounts shown above include only swaps from the International Equity Pool.

### *Securities Lending*

State statutes allow the System to participate in securities lending transactions, and the System has, by way of a Security Lending Authorization Agreement, authorized the agent bank to lend the System's securities to broker-dealers and banks pursuant to a form of loan agreement.

During the fiscal year, the agent bank lent, at the direction of the System, the System's securities and received cash (United States and foreign currency), securities issued or guaranteed by the United States government, sovereign debt rated A or better, convertible bonds and irrevocable bank letters of credit as collateral. The agent bank did not have the ability to pledge or sell collateral securities delivered absent a borrower default. Borrowers were required to deliver collateral for each loan equal to (i) in case of loaned securities denominated in United States dollars or whose primary trading market was located in the United States or sovereign debt issued by foreign governments, 102% of the market value of the loaned securities; and (ii) in the case of loaned securities not denominated in United States dollars or whose primary trading market was not located in the United States, 105% of the market value of the loaned securities.

The System did not impose any restrictions during the fiscal year on the amount of loans that the agent bank made on its behalf and the agent bank indemnified the System by agreeing to purchase replacement securities, or return cash collateral in the event the borrower failed to return the loaned security or to pay distributions thereon. There were no such failures by any borrowers during the fiscal year. Moreover, there were no losses during the fiscal year resulting from a default of the borrowers or the agent bank.

During the fiscal year, the System and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested in a collateral account dedicated to the System. As of September 30, 2007, such account had an average weighted maturity to next reset of 25 days and an average weighted maturity of 710 days. Because the loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral. On September 30, 2007, the System had no credit risk exposure to borrowers. The cash collateral held for securities on loan for the System as of September 30, 2007 was \$282,596,545. The carrying amount, which is the fair market value, of securities on loan for the System as of September 30, 2007, was \$275,481,050.

Gross income from security lending for the fiscal year was \$12,898,813. Expenses associated with this income were the borrower's rebate of \$12,278,704 and fees paid to the agent of \$98,147.

### *Risk*

In accordance with GASB Statement No. 40, investments require certain disclosures regarding policies and practices, and the risks associated with them. The credit risk (including custodial credit risk and concentration of credit risk), the interest rate risk, and the foreign currency risk are discussed in the following paragraphs. Amounts represent the pro rata share of the underlying investments as required by GASB No. 40. These are held in internal investment pools and reported as such in the financial statements.

# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

Credit Risk - Credit risk is the risk that an issuer will not fulfill its obligations.

- Short-Term Fixed Income Investments - Prime commercial paper investments must be rated A-1 or P-1 at the time of purchase as rated by the two major rating services Standard and Poor's Corporation (S&P) and Moody's Investor Service (Moody's), respectively. Borrowers must have at least \$400.0 million in commercial paper outstanding, and the State Treasurer may not invest in more than 10% of the borrowers outstanding debt. The investments are further limited to \$200.0 million in any borrower, unless the borrower has a A-1+ rating in which case the investment is not to exceed \$300.0 million.
- Long-Term Fixed Income Investments – These investments must be investment grade or better at the time of purchase unless specific requirements are met as defined by PA 314 of 1965, as amended, and the State Treasurer's investment policy. Law defines investment grade as investments in the top four major grades, rated by two national rating services, S&P (AAA, AA, A, BBB) and Moody's (Aaa, Aa, A, Baa). At September 30, 2007, the System was in compliance with the policy in all material aspects.

### Rated Debt Investments (In thousands of dollars) As of September 30, 2007 and 2006

Investment Type	September 30, 2007				September 30, 2006			
	Fair Value	S&P	Fair Value	Moody's	Fair Value	S&P	Fair Value	Moody's
Short Term	\$ 59,886	A-1	\$ 62,731	P-1	\$ 55,498	A-1	\$ 65,420	P-1
	-	A-2	-	P-2	1,909	A-2	2,672	P-2
	6,388	NR	3,543	NR	14,496	NR	3,811	NR
U.S. Agencies- Sponsored	76,297	AAA	76,297	Aaa	64,671	AAA	64,671	Aaa
	-	NR	-	NR	1,739	NR	1,739	NR
Corporate Bonds & Notes	16,814	AAA	15,556	Aaa	12,438	AAA	12,756	Aaa
	19,284	AA	21,219	Aa	17,374	AA	23,435	Aa
	34,340	A	33,128	A	31,539	A	20,968	A
	13,574	BBB	14,644	Baa	7,906	BBB	10,141	Baa
	385	BB	369	Ba	130	BB	471	Ba
	90	B	-	B	74	B	-	B
	-	CCC	39	Caa	-	CCC	-	Caa
	3,707	NR	3,239	NR	1,767	NR	3,457	NR
International *	7,094	AAA	7,094	Aaa	8,671	AAA	7,574	Aaa
	20,376	AA	33,705	Aa	19,319	AA	30,842	Aa
	9,788	A	2,153	A	25,461	A	12,184	A
	7,843	NR	2,149	NR	-	NR	2,851	NR
Equity*	-	AA	-	Aa	1,116	AA	7,357	Aa
	-	A	-	A	6,241	A	-	A
Total	<u>\$ 275,866</u>		<u>\$ 275,866</u>		<u>\$ 270,349</u>		<u>\$ 270,349</u>	

NR - not rated

\* International and Equity Investment types consist of domestic floating rate note used as part of a Swap strategy.

# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

Custodial Credit Risk - Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty, the State will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party.

- Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the government and are held by either:
- The counterparty or
- The counterparty's trust department or agent but not in the government name.

The State Treasurer does not have a policy for custodial credit risk. However, the State's custodial bank had a credit rating of AA at September 30, 2007. As of September 30, 2007 and 2006, Government securities with a market value of \$536 thousand and \$527 thousand, respectively, were exposed to custodial credit risk. These securities were held by the counterparty not in the name of the System.

Concentration of Credit Risk - Concentration of credit Risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer.

Other than obligations issued, assumed or guaranteed by the United States, its agencies or United States government sponsored enterprises, the System is prohibited by P.A. 314 of 1965, as amended, from investing in more than 5% of the outstanding obligations of any one issuer or investing more than 5% of a system's assets in the obligations of any one issuer.

At September 30, 2007, and 2006 there were no investments in any single issuer that accounted for more than 5% of the System's assets nor were there any investments totaling more than 5% of the obligations of any one issuer, other than U.S. Government Securities as described above.

Interest Rate Risk - Fixed Income Investments - Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment.

The State Treasurer's policy states that cash equivalents are invested in short term fixed income securities with an average weighted maturity of less than one year to provide liquidity and safety of principal from capital market and default risk. At September 30, 2007 and 2006, the fair value of the System's prime commercial paper was \$66.1 million and \$72.0 million with the weighted average maturity of 12 days and 41 days, respectively.

The State Treasurer does not have a policy regarding interest rate risk for long term debt investments. However, the pension funds are invested with a long term strategy. The goal is to balance higher returns while accepting minimum risk for the return. Analyzing the yield curve on individual securities as compared to U.S. Treasuries determines, in part, what is an acceptable risk for the return. Therefore, market conditions such as lower interest rates result in shorter duration and higher interest rates result in longer duration.

# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

### Debt Securities (in thousands) As of September 30, 2007 and 2006

	2007		2006	
	Fair Value	Effective Duration in Years	Fair Value	Effective Duration in Years
<b>Government</b>				
U. S. Treasury	\$ 11,327	4.8	\$ 12,567	3.1
U. S. Agencies - Backed	35,159	5.7	27,113	5.7
U. S. Agencies - Sponsored	76,297	3.3	66,409	3.7
<b>Corporate</b>	88,194	4.9	71,228	4.4
<b>International*</b>				
U. S. Treasury	2,139	0.1	2,190	0.5
U. S. Agencies - Sponsored	0		1,092	0.1
Corporate	45,101	0.1	52,359	0.1
<b>Equities*</b>				
Corporate	0		7,357	0.6
<b>Total</b>	<u>\$ 258,217</u>		<u>\$ 240,315</u>	

\*International and Equities contain U.S. Government and Corporate Debt Securities as a part of their derivative strategies. The interest rates reset on a quarterly basis for these securities.

**Foreign Currency Risk** - Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit.

The System invests in various securities denominated in foreign currencies. These investments are limited to 20% of the total assets of the System with an additional limit of 5% of the outstanding foreign securities of any single issuer. No investment is allowed in a country that has been identified by the United States State Department as engaging in or sponsoring terrorism. These limits are set forth in P.A. 314 of 1965, as amended. The types of foreign investments include equities, fixed income, mutual funds, real estate, and limited partnerships. At September 30, 2007 and 2006, the total amount of foreign investment subject to foreign currency risk was \$109.7 million and \$69.5 million which amounted to 8.2% and 5.8% of total investments of the System, exclusive of cash collateral on loaned securities, respectively.

# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

Foreign Currency Risk  
(in thousands)  
As of September 30, 2007

Region	Country	Currency	Alt. Invest.	Equity	Real Estate	International						
			Market Value	Market Value	Market Value	Equities	Derivatives					
			in U.S. \$	in U.S. \$	in U.S. \$	Market Value	Market Value					
			in U.S. \$	in U.S. \$	in U.S. \$	in U.S. \$	in U.S. \$ *					
<b><u>AMERICA</u></b>												
	Canada	Dollar				\$	1,251					
	Mexico	Peso		\$	2,159							
<b><u>EUROPE</u></b>												
	European Union	Euro	\$	17,373	1,229		4,939	\$	4,445			
	Switzerland	Franc			1,457		911		824			
	Sweden	Krona					406		255			
	Denmark	Krone			20		270		73			
	Norway	Krone					321		48			
	U.K.	Sterling		708	101		2,432		1,848			
<b><u>PACIFIC</u></b>												
	Australia	Dollar					1,202		763			
	China	Renminbi			277							
	Hong Kong	Dollar					439		719			
	India	Rupee			13							
	Japan	Yen		119	3,650		2,904		1,133			
	Singapore	Dollar					155		125			
	South Korea	Won					453		633			
<b><u>VARIOUS</u></b>												
					\$	11,747	44,250					
	Total		\$	18,200	\$	8,906	\$	11,747	\$	59,933	\$	10,866

\* Note: International derivatives' market value exposure to foreign currency risk is the net amount of unrealized gains and unrealized losses. Maturity dates on these investments range from October 2007 through September 2010 with an average maturity of 1.2 years.

# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

### Foreign Currency Risk

(in thousands)

As of September 30, 2006

Region	Country	Currency	Alt. Invest.	Equity	Real Estate	International	
			Market Value in U.S. \$	Market Value in U.S. \$	Market Value in U.S. \$	Equities Market Value in U.S. \$	Derivatives Market Value in U.S. \$ *
<u>AMERICA</u>							
	Canada	Dollar		\$ 405			
	Mexico	Peso		1,572			
<u>EUROPE</u>							
	European Union	Euro	\$ 10,103	2,727		\$ 706	\$ 5,153
	Switzerland	Franc		904			1,131
	Sweden	Krona		186			237
	Denmark	Krone				13	176
	Norway	Krone		92		1	192
	U.K.	Sterling	537	1,220		53	2,815
<u>PACIFIC</u>							
	Australia	Dollar		325			700
	Hong Kong	Dollar		64			475
	Japan	Yen	181	1,651		7	2,599
	Singapore	Dollar					109
	South Korea	Won		199			889
<u>VARIOUS</u>							
				13,711	\$ 4,622	15,791	
	Total		\$ 10,821	\$ 23,056	\$ 4,622	\$ 16,571	\$ 14,476

\* Note: International derivatives' market value exposure to foreign currency risk is the net amount of unrealized gains and unrealized losses. Maturity dates on these investments range from October 2006 through November 2008 with an average maturity of 1.1 years.



# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

### NOTE 5 – ACCOUNTING CHANGES

The GASB has issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which establishes uniform standards of financial reporting by state and local governmental entities for other postemployment benefit (OPEB) plans. The requirements of this statement are effective one year prior to the effective date of the related Statement (GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*) for the employer or the largest employer in the plan. Because the State of Michigan is a phase 1 government (those with total annual revenues of \$100 million or more), the System is required to implement Statement No. 43 in financial statements for periods beginning after December 15, 2005. The statement was adopted in fiscal year 2007 and is reflected in this report.

The GASB has issued Statement No. 50, *Pension Disclosures*, which amends GASB Statements No. 25 and No. 27, and more closely aligns the financial reporting requirements for pensions with those for OPEB. This statement is effective for periods beginning after June 15, 2007. Early implementation is encouraged. With the implementation of Statement No. 43 in fiscal year 2007, we have chosen to early implement Statement No. 50 as reflected in this report.

### NOTE 6 - COMMITMENTS AND CONTINGENCIES

Under the Administrative Procedures Act, members may appeal a decision by the Board. Once the administrative procedure has been exhausted, the decision may be appealed in Michigan's court system. Various cases that have exhausted the administrative procedures have been appealed in the court system. These cases are in the normal course of business and the System does not anticipate any material loss as a result of the contingent liabilities.

# FINANCIAL SECTION

## Required Supplementary Information

### Schedules of Funding Progress

Expressing the net assets available for benefits as a percentage of the actuarial accrued liability provides one indication of the System's funding status. Analysis of this percentage over time indicates whether the System is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the System. Trends in unfunded actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the unfunded or overfunded actuarial accrued liability as a percentage of annual covered payroll approximately adjusts for the effects of inflation and aids analysis of progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the stronger the System.

#### Retirement Benefits (\$ in millions)

Valuation Date Sept 30	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded (Overfunded) Accrued Liability (UAAL) (b-a)	Funded Ratio AAL (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
1997	\$ 787.2	\$ 880.3	\$ 93.1	89.4 %	\$ 110.1	84.6 %
1997 <sup>(1)</sup>	928.7	880.3	(48.4)	105.5	110.1	(44.0)
1997 <sup>(3)</sup>	928.7	876.8	(52.0)	105.9	110.1	(47.2)
1998	974.4	943.7	(30.6)	103.2	108.2	(28.3)
1998 <sup>(2)</sup>	974.4	962.5	(11.9)	101.2	108.2	(11.0)
1999	1,036.8	1,006.5	(30.3)	103.0	116.9	(25.9)
2000	1,113.1	1,040.7	(72.4)	107.0	116.6	(62.1)
2001	1,148.6	1,073.6	(75.0)	107.0	118.8	(63.1)
2002	1,141.3	1,135.7	(5.6)	100.5	124.4	(4.6)
2003	1,139.1	1,186.4	47.3	96.0	113.2	41.8
2004 <sup>(4)</sup>	1,117.7	1,255.8	138.1	89.0	119.7	115.4
2005	1,090.3	1,300.3	210.0	83.8	117.6	178.5
2006	1,113.5	1,385.9	272.4	80.3	115.9	235.0
2006 <sup>(1)</sup>	1,204.2	1,385.9	181.7	86.9	115.9	156.8

(1) Change in asset valuation method.

(2) Assumption change.

(3) Change in inflation.

(4) Revised actuarial assumptions and benefit provisions.

#### Other Postemployment Benefits (\$ in millions)

Valuation Date Sept 30	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded (Overfunded) Accrued Liability (UAAL) (b-a)	Funded Ratio AAL (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
2006	\$ -	\$ 944.4	\$ 944.4	0.0 %	\$ 115.9	814.9 %

## Required Supplementary Information (Continued)

### Schedules of Employer Contributions

#### Retirement Benefits

<b>Fiscal Year Ended Sept. 30</b>	<b>Required Contribution (ARC)</b>	<b>Actual Contribution</b>	<b>Percentage Contributed</b>
1998	\$ 20,257,237	\$ 20,003,807	98.7 %
1999	22,733,833	21,609,520	95.1
2000	24,266,567	22,107,292	91.1
2001	21,989,439	24,064,039	109.4
2002	22,041,827	22,456,469	101.9
2003	26,683,625	25,931,762	97.2
2004	26,997,861	24,792,137	91.8
2005	32,151,494	26,607,572	82.8
2006	36,063,260	26,103,923	72.4
2007	32,386,761 <sup>1</sup>	24,323,324	75.1

<sup>1</sup> Pursuant to Public Act 22 of 2007, the System's assets were revalued to their actual market value as of September 30, 2006. The five-year smoothing will begin again in fiscal year 2008.

#### Other Postemployment Benefits

<b>Fiscal Year Ended Sept. 30</b>	<b>Required Contribution (ARC)</b>	<b>Actual Contribution</b>	<b>Percentage Contributed</b>
2007	\$ 59,691,819	\$ 27,840,439	46.6 %

# **FINANCIAL SECTION**

## **Notes to Required Supplementary Information**

### **NOTE A - DESCRIPTION**

Ten year historical trend information designed to provide information about the System's progress made in accumulating sufficient assets to pay benefits when due is presented in the preceding schedules. Other ten year historical trend information related to the System is presented in the Statistical and Actuarial Sections of the report. This information is presented to enable the reader to assess the progress made by the System in accumulating sufficient assets to pay pension and other postemployment benefits as they become due. Because this is the first year the system is reporting other postemployment benefits in accordance with GASB Statement No. 43, only one year of historical trend information is provided. In the transition year, and until three actuarial valuations have been performed in accordance with the parameters, the required schedules of funding progress and employer contributions will include information for as many valuations as are available.

The comparability of trend information is affected by changes in actuarial assumptions, benefit provisions, actuarial funding methods, accounting policies, and other changes. Those changes usually affect trends in contribution requirements and in ratios that use the pension and other postemployment benefit obligations as a factor.

The Schedules of Funding Progress and Schedules of Employer Contributions are reported as historical trend information. The Schedules of Funding Progress are presented to measure the progress being made to accumulate sufficient assets to pay benefits when due. The Schedules of Employer Contributions are presented to show the responsibility of the Employer in meeting the actuarial requirements to maintain the System on a sound financial basis.

# FINANCIAL SECTION

## Supporting Schedules

### Comparative Summary Schedule of Pension Plan Administrative Expenses For Fiscal Years Ended September 30, 2007 and 2006

	2007	2006
<b>Personnel Services:</b>		
Staff Salaries	\$ 57,535	\$ 56,565
Retirement and Social Security	14,594	15,490
Other Fringe Benefits	12,254	10,588
<b>Total</b>	<b>84,383</b>	<b>82,643</b>
<b>Professional Services:</b>		
Accounting	14,476	11,898
Actuarial	89,300	63,492
Attorney General	37,245	28,386
Audit	35,407	30,795
Consulting	3,878	9,342
Medical	9,584	4,704
<b>Total</b>	<b>189,890</b>	<b>148,617</b>
<b>Building Equipment</b>		
Building Rentals	7,395	5,631
Equipment Purchase, Maintenance, and Rentals	547	499
<b>Total</b>	<b>7,942</b>	<b>6,130</b>
<b>Miscellaneous</b>		
Travel and Board Meetings	220	313
Office Supplies	532	655
Postage, Telephone, and Other	28,364	24,899
Printing	4,304	3,745
Technological Support	85,935	76,203
<b>Total</b>	<b>119,355</b>	<b>105,815</b>
<b>Total Administrative Expenses</b>	<b>\$ 401,570</b>	<b>\$ 343,205</b>

# FINANCIAL SECTION

## Supporting Schedules (Continued)

### Schedule of Investment Expenses For Fiscal Years Ended September 30, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Real Estate Operating Expenses	\$ 30,481	\$ 10,033
Securities Lending Expenses	12,376,851	4,224,292
Other Investment Expenses*		
ORS-Investment Expenses	240,125	225,515
Custody Fees	28,977	25,938
Management Fees-Real Estate	102,877	63,870
Management Fees-Alternative	1,415,189	1,216,000
Management Fees-International	51,672	-
Research Fees	25,517	23,607
<b>Total Investment Expenses</b>	<u><u>\$ 14,271,689</u></u>	<u><u>\$ 5,789,255</u></u>

\*Refer to Investment Section for fees paid to investment professionals.

### Schedule of Payments to Consultants For Fiscal Years Ended September 30, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Independent Auditors	\$ 35,407	\$ 30,795
Consulting	3,878	9,342
Medical	9,584	4,704
Attorney General	37,245	28,386
Accounting	14,476	11,898
Actuary	89,300	63,492
<b>Total Payment to Consultants</b>	<u><u>\$ 189,890</u></u>	<u><u>\$ 148,617</u></u>

# FINANCIAL SECTION

## Supporting Schedules (Continued)

### Detail of Changes in Plan Net Assets (Pension and Other Postemployment Benefits)

For the Year Ended September 30, 2007

	Employee Contributions	Employer Contributions	Retired Benefit Payments*	Undistributed Investment Income	OPEB Related Benefits	Total
<b>Additions:</b>						
Contributions:						
Member contributions	\$ 101,205				\$ 1,219,760	\$ 1,320,965
Employer contributions		\$ 24,323,324			27,840,439	52,163,763
Total Contributions	101,205	24,323,324	-	-	29,060,199	53,484,728
Investment income (loss):						
Net appreciation (depreciation) in fair value of investments				\$ 175,536,957		175,536,957
Interest, dividends, and other				27,449,950		27,449,950
Investment expenses:						
Real estate operating expenses				(30,481)		(30,481)
Other investment expenses				(1,864,357)		(1,864,357)
Securities lending activities:						
Securities lending income				12,898,813		12,898,813
Securities lending expenses				(12,376,851)		(12,376,851)
Net investment income (loss)	-	-	-	201,614,031	-	201,614,031
Miscellaneous income			\$ 44,583	1,975	-	46,558
<b>Total additions</b>	101,205	24,323,324	44,583	201,616,006	29,060,199	255,145,317
<b>Deductions:</b>						
Benefits paid to plan members and beneficiaries:						
Retirement benefits			84,930,044			84,930,044
Health benefits					26,675,560	26,675,560
Dental/vision benefits					2,384,639	2,384,639
Refunds of member contributions		1,087				1,087
Administrative expenses				401,570		401,570
<b>Total deductions</b>	-	1,087	84,930,044	401,570	29,060,199	114,392,900
<b>Net Increase (Decrease) Before Other Changes</b>	101,205	24,322,237	(84,885,461)	201,214,436	-	140,752,417
<b>Other Changes in Net Assets:</b>						
Interest allocation	12,007	5,549,337	72,245,852	(77,807,196)		-
Transfers upon retirement	(15,132)	(78,831,457)	78,846,589			-
<b>Total other changes in net assets</b>	(3,125)	(73,282,120)	151,092,441	(77,807,196)	-	-
<b>Net Increase (Decrease)</b>	98,080	(48,959,883)	66,206,980	123,407,240	-	140,752,417
<b>Net Assets Held in Trust for Pension and OPEB Benefits:</b>						
<b>Beginning of Year</b>	553,624	69,366,717	903,073,149	231,254,177	-	1,204,247,667
<b>End of Year</b>	\$ 651,704	\$ 20,406,834	\$ 969,280,129	\$ 354,661,417	\$ -	\$ 1,345,000,084

\*Casualty Reserve is included.

# FINANCIAL SECTION

## Supporting Schedules (Continued)

### Detail of Changes in Plan Net Assets (Pension and Other Postemployment Benefits)

For the Year Ended September 30, 2006

	Employee Contributions	Employer Contributions	Retired Benefit Payments*	Undistributed Investment Income	OPEB Related Benefits	Total
<b>Additions:</b>						
Contributions:						
Member contributions	\$ 252,805				\$ 1,254,352	\$ 1,507,157
Employer contributions		\$ 26,103,923			25,021,287	51,125,210
Total Contributions	252,805	26,103,923	-	-	26,275,639	52,632,367
Investment income (loss):						
Net appreciation (depreciation) in fair value of investments				\$ 113,988,819		113,988,819
Interest, dividends, and other				27,976,618		27,976,618
Investment expenses:						
Real estate operating expenses				(10,033)		(10,033)
Other investment expenses				(1,554,930)		(1,554,930)
Securities lending activities:						
Securities lending income				4,389,349		4,389,349
Securities lending expenses				(4,224,292)		(4,224,292)
Net investment income (loss)	-	-	-	140,565,531	-	140,565,531
Miscellaneous income				6	4,319	4,325
<b>Total additions</b>	252,805	26,103,923	-	140,565,537	26,279,958	193,202,223
<b>Deductions:</b>						
Benefits paid to plan members and beneficiaries:						
Retirement benefits			\$ 82,316,931			82,316,931
Health benefits					27,090,226	27,090,226
Dental/vision benefits					2,402,514	2,402,514
Refunds of member contributions	802	142,177				142,979
Administrative expenses				343,205		343,205
<b>Total deductions</b>	802	142,177	82,316,931	343,205	29,492,740	112,295,855
<b>Net Increase (Decrease) Before Other Changes</b>	252,003	25,961,746	(82,316,931)	140,222,332	(3,212,782)	80,906,368
<b>Other Changes in Net Assets:</b>						
Interest allocation	11,234	5,509,495	70,697,225	(76,217,954)		-
Transfers upon retirement	(4,330)	(30,973,208)	30,977,538			-
<b>Total other changes in net assets</b>	6,904	(25,463,713)	101,674,763	(76,217,954)	-	-
<b>Net Increase (Decrease)</b>	258,907	498,033	19,357,832	64,004,378	(3,212,782)	80,906,368
<b>Net Assets Held in Trust for Pension and OPEB Benefits:</b>						
<b>Beginning of Year</b>	294,717	68,868,684	883,715,317	167,249,799	3,212,782	1,123,341,299
<b>End of Year</b>	\$ 553,624	\$ 69,366,717	\$ 903,073,149	\$ 231,254,177	\$ -	\$ 1,204,247,667

\*Casualty Reserve is included.



# INVESTMENT SECTION

Prepared by Michigan Department of Treasury, Bureau of Investments

Jon M. Braeutigam, Acting Director

Report on Investment Activity

Asset Allocation

Investment Results

List of Largest Stock Holdings

List of Largest Bond Holdings

Schedule of Investment Fees

Schedule of Investment Commissions

Investment Summary

# INVESTMENT SECTION

## Report on Investment Activity

### INTRODUCTION

The State Treasurer reports investment activity quarterly to the Investment Advisory Committee (Committee), which reviews the investments, goals, and objectives of the retirement funds and may submit recommendations regarding them to the State Treasurer. The Investment Advisory Committee may also, by a majority vote, direct the State Treasurer to dispose of any holdings that, in the Committee's judgment, are not suitable for the funds involved, and may, by unanimous vote, direct the State Treasurer to make specific investments.

The Investment Advisory Committee was created by Act 380 of the Public Acts of 1965. The three public members of the five-member committee are appointed by the Governor with the advice and consent of the Senate for three-year terms. The Director of the Department of Labor and Economic Growth and the Director of the Department of Management and Budget are ex-officio members. As of September 30, 2007, members of the Committee were as follows: David G. Sowerby, CFA (public member), Robert E. Swaney, CFA (public member), James B. Jacobs (public member), Keith W. Cooley (ex-officio member), and Lisa Webb Sharpe (ex-officio member). The public members serve without pay, but may be paid actual and necessary travel and other expenses.

### INVESTMENT POLICY & GOALS

Investment policy states that the fiduciary will operate within standard investment practices of the prudent person and in accordance with Public Employee Retirement System Investment Act 314 of 1965. The fiduciary is authorized to invest in government obligations, corporate obligations, various short-term obligations, corporate (domestic and international) stocks, private equity interests, mutual funds, real estate interests, and other investments subject to specific parameters. Above all, pension fund assets are to be invested for the exclusive benefit of the members of the System, in a fiduciary capacity.

The System's Proxy Voting Policy sets forth directives on the following issues: Boards of Directors, corporate governance, social issues, corporate restructurings and defenses. All proxies are reviewed and voted in accordance with the System's policy.

The primary function of the System is to provide retirement, survivor and disability benefits to its members. The State Treasurer is the sole investment fiduciary and custodian of the System's investments pursuant to State law. The goals of the System are:

1. Achieve the optimal rate of return possible within prudent levels of risk.
2. Maintain sufficient liquidity to pay benefits.
3. Diversify assets to preserve capital and avoid large losses.
4. Meet or exceed the actuarial assumption over the long term.
5. Perform in the top half of the public plan universe over the long term.
6. Exceed individual asset class benchmarks over the long term.
7. Operate in a cost-effective manner.

The strategy for achieving these goals is carried out by investing the assets of the System according to a three-year asset allocation model. The System currently has seven different asset classes it invests in, which provides for a well-diversified portfolio.

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

### Asset Allocation (Excludes Collateral on Loaned Securities)

<u>Investment Category</u>	<u>As of 9/30/07 Actual %</u>	<u>Three-Year Target %</u>
Domestic Equity - Active	29.0%	24.0%
Large Cap Core Pool	15.4%	
Large Cap Value Pool	4.9%	
Large Cap Growth Pool	5.4%	
Mid Cap Pool	2.3%	
Small Cap Pool	1.0%	
Domestic Equity - Passive	17.8%	16.0%
S&P 500 Index Pool	16.1%	
S&P Mid Cap Index Pool	1.7%	
International Equity	11.3%	12.0%
International Equity Pool - Passive	8.5%	
International Equity Pool - Active	2.8%	
Alternative Investments Pool	14.0%	14.0%
Real Estate Pool	9.7%	10.0%
Fixed Income	16.3%	22.0%
Government Bond Pool	8.0%	
Corporate Bond Pools	5.3%	
Fixed Income Bond Pools	2.6%	
Treasury Inflation Prot. Sec. Pool	0.4%	
Short Term Investment Pool	1.9%	1.0%
Commodities	0.0%	1.0%
<b>TOTAL</b>	<b>100.0%</b>	<b>100.0%</b>

## INVESTMENT AUTHORITY

Pursuant to State Law (Section 91 of Act No. 380 of the Public Acts of 1965, as amended), the State Treasurer, State of Michigan, is the investment fiduciary for the following four State sponsored retirement systems: Michigan Public School Employees' Retirement System, Michigan State Employees' Retirement System, Michigan State Police Retirement System, and Michigan Judges' Retirement System.

Act No. 314 of the Public Acts of 1965, as amended, authorizes the investment of assets of public employee retirement systems or plans created and established by the State or any political subdivision.

## INVESTMENT RESULTS

### *Total Portfolio Results*

For the fiscal year ended September 30, 2007, the total System's rate of return was 17.4% as compiled by State Street Analytics. Annualized rates of return for the three-year period ending September 30, 2007, were 14.4%; for the five-year period were 14.0%; and for the ten-year period were 8.1%.

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

Returns were calculated using a time-weighted rate of return in accordance with industry standards, unless a modification is described in the discussion of the reported return.

Investment results were once again driven by double-digit returns from every major asset class except fixed income and short-term investments. Equity performance was strong much of the year in spite of soaring commodity and energy prices. International stocks turned in the best performance, led by emerging markets and the benefit of a declining dollar. Domestic equities were also strong, with mid cap stocks (S&P 400) turning in the best performance for the period, followed by larger companies (S&P 500) then small cap (S&P 600). Credit markets experienced turmoil in July and August due to problems associated with subprime mortgages and concerns with housing. However, a 50 basis point cut in the federal funds rate in mid September provided some stability to the credit markets as well as a positive lift to the equity markets. The Alternative Investments Division continued to benefit from an extraordinarily liquid credit environment that fueled strong mergers and acquisitions, for most of the year, and refinancing activity for its buyout sector. Robust commercial real estate markets allowed the Real Estate pool to experience strong gains from both sales and appraisals of property. Investment grade bonds generally had positive returns for the year. The yield curve shifted from being inverted to being positively sloped as ten to thirty year rates remained relatively unchanged while short-term to ten year rates declined.

For the fiscal year, the Dow Jones Industrial Average provided a total return of 21.7%, while the broader based S&P 500 returned 16.4%. The Lehman Brothers U.S. Government/Credit Bond Index appreciated 5.08%.

The U.S. economy grew at an estimated rate of 2.6% in fiscal year 2007 as measured by real gross domestic product. The first half was weak due to a significant rise in imports and a decline in inventories. The second half of the fiscal year picked up due to a narrowing of the trade deficit, a pick up in defense spending and a surge in commercial construction. Corporate earnings remained strong for most of the year, led by robust profits from energy companies and a rebound in technology, but earnings growth slowed for some sectors, namely housing and financials, late in the year. Strong demand sent commodity and energy prices climbing during most of the year, with oil moving close to \$80 per barrel in September.

For the first time since June of 2003, Federal Reserve Chairman Ben Bernanke and the Federal Reserve decided unanimously to cut the federal funds rate from 5.25% to 4.75%. They expressed a general concern that tightening credit conditions and disruptions in the financial markets might have the potential to intensify the housing correction and possibly restrain future economic growth.

The System remains well diversified, both across and within asset classes, and positioned to benefit from moderate economic growth.

### ***Large Cap Core Pool***

The objective of the pool of large company core stocks is to generate a rate of return from investment in common stocks and equity equivalents that exceeds that of the S&P 500 Index.

The pool invests primarily in equities and equity-related securities of U.S. companies with market capitalization generally greater than \$5 billion that have passed several screens based on the stocks' valuation, risk attributes and tracking error relative to the overall index. The goal is to build a portfolio of stocks that will provide excess returns relative to the S&P 500 while providing minimal tracking error to the index. At times a portion of the pool may be invested in exchange traded funds (ETFs) and fixed-income short-term securities with maturities of less than one year.

The pool invests in equities and equity related securities that are listed on U.S. national securities exchanges, including American Depositary Receipts (ADRs). It may also invest in stocks that are traded over-the-counter. The pool diversifies its investments by allocating its equities with consideration of the weightings of the S&P 500 Index.

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

The following summarizes the weightings of the pool as of September 30, 2007:

Financials	20.5 %
Technology	17.2
Healthcare	12.9
Consumer Discretionary	11.5
Industrials	10.3
Consumer Staples	9.3
Energy	8.7
Utilities	3.2
Telecom	3.0
Materials	2.5
Short Term Investments	0.9
<b>Total</b>	<b><u>100.0 %</u></b>

The System's Large Cap Core pool was established in July of 2007, and therefore does not have performance for the entire 2007 fiscal year.

At the close of fiscal year 2007, the Large Cap Core pool represented 15.4% of total investments. The following summarizes the System's 2.1% ownership share of the Large Cap Core pool at September 30, 2007:

### Large Cap Core Pool (in thousands)

Short Term Pooled investments	\$ 584
Equities	205,439
Settlement Principal Payable	(377)
Accrued dividends	253
<b>Total</b>	<b><u>\$ 205,899</u></b>

### *Large Cap Value Pool*

The objective of the pool of large company value stocks is to generate a rate of return from investment in common stocks and equity equivalents that exceeds that of the S&P Citigroup Value Index.

The pool invests primarily in equities and equity-related securities of U.S. companies with market capitalization generally greater than \$5 billion that are significantly under-priced as measured by several valuation criteria, including price-to-earnings and price-to-book value ratios, as well as below fair value as determined by several quantitative and qualitative valuation models. The focus is on companies trading 25% or more below estimated fair value with experienced management and conservative accounting practices. At times a portion of the pool may be invested in fixed-income short-term securities with maturities of less than one year.

The pool invests in equities and equity related securities that are listed on U.S. national securities exchanges, including American Depositary Receipts (ADRs). It may also invest in stocks that are traded over-the-counter. The pool diversifies its investments by allocating its equities among ten sectors with some consideration to the weightings of the S&P Citigroup Value Index.

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

The following summarizes the weightings of the pool as of September 30, 2007:

Financials	33.0 %
Healthcare	17.8
Consumer Discretionary	9.5
Energy	9.3
Technology	8.1
Short Term Investments	6.6
Consumer Staples	5.9
Industrials	3.7
Telecom	3.2
Materials	2.2
Utilities	0.7
<b>Total</b>	<b><u>100.0 %</u></b>

The System's Large Cap Value pool achieved a total rate of return of 13.7% for fiscal year 2007. This compared with 16.1% for the S&P 500 Citigroup Value Index.

At the close of fiscal year 2007, the Large Cap Value pool represented 4.9% of total investments. This compares to 13.0% for fiscal year 2006. The following summarizes the System's 2.1% ownership share of the Large Cap Value pool at September 30, 2007:

### Large Cap Value Pool (in thousands)

Short Term Pooled investments	\$ 2,558
Equities	63,308
Accrued dividends	49
<b>Total</b>	<b><u>\$ 65,915</u></b>

### *Large Cap Growth Pool*

The primary investment objective is to generate a rate of return from investment in common stocks and equity equivalents that exceeds that of the S&P Citigroup Growth Index.

The pool invests primarily in equities and equity-related securities of U.S. companies with market capitalization generally greater than \$3 billion and which offer above-average and sustainable growth in revenues, earnings, cash flow, identifiable catalysts, and reasonable valuations relative to their fundamentals. The focus is on companies with a strong presence in categories anticipated to be fast growing, with high rates of unit sales growth and seasoned management. At times a portion of the pool may be invested in fixed-income short-term securities with maturities of less than one year.

The pool invests in equities and equity related securities that are listed on U.S. national securities exchanges, including American Depositary Receipts (ADRs). It may also invest in stocks that are traded over-the-counter. The pool diversifies its investments by allocating its equities with weightings that approximate the weightings of the S&P Citigroup Growth Index.

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

The following summarizes the weightings of various sectors in the pool as of September 30, 2007:

Technology	22.9 %
Healthcare	17.2
Energy	14.7
Consumer Staples	13.0
Industrials	11.1
Financials	8.7
Consumer Discretionary	8.3
Short Term Investments	3.4
Utilities	0.4
Materials	0.3
<b>Total</b>	<b><u>100.0 %</u></b>

The Large Cap Growth pool's total rate of return was 19.8% for fiscal year 2007 versus 16.8% for the S&P 500 Citigroup Growth Index.

At the close of fiscal year 2007, the Large Cap Growth pool represented 5.4% of total investments. This compares to 13.0% for fiscal year 2006. The following summarizes the System's 2.1% ownership share of the Large Cap Growth pool at September 30, 2007:

### Large Cap Growth Pool (in thousands)

Short Term Pooled investments	\$ 985
Equities	71,608
Accrued dividends	27
<b>Total</b>	<b><u>\$ 72,620</u></b>

### *Mid Cap Pool*

Nine Mid Cap managers were selected in 2005 and they were funded out of the Large Cap Value and Growth pools. The manager's investment styles range from value, growth and core and they select stocks with average market capitalizations greater than \$1 billion but less than \$5 billion. The investment objective of the Mid Cap manager pool is to generate a combined rate of return from investment in common stocks and equivalents that exceeds the S&P 400 Mid Cap Index.

The Mid Cap pool return for fiscal year 2007 was 22.6% versus the benchmark's 18.8%.

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

At the close of fiscal year 2007, the Mid Cap pool represented 2.3% of total investments. This compares to 2.1% for fiscal year 2006. The following summarizes the System's ownership share and composition of the Mid Cap pool at September 30, 2007:

### Mid Cap Value and Core Pools (in thousands)

	Artisan Mid Cap Value	Cramer Rosenthal McGlynn Mid Cap Value	Los Angeles Capital Mid Cap Core	Wellington Management Mid Cap Core
Total Investment	\$ 4,916	\$ 4,898	\$ 3,086	\$ 4,319
Ownership Percentage	2.2%	2.2%	2.2%	2.2%

### Mid Cap Growth Pools (in thousands)

	Alliance Mid Cap Growth	Putnam Mid Cap Growth	Rainer Mid Cap Growth	UBS Mid Cap Growth	Wellington Management Mid Cap Growth
Total Investment	\$ 3,305	\$ 1,283	\$ 3,163	\$ 2,852	\$ 2,929
Ownership Percentage	2.2%	2.2%	2.2%	2.2%	2.2%

### *Small Cap Pool*

The primary investment objective is to generate a rate of return from investment in common stocks and equivalents that exceeds the S&P 600 Small Cap Index by selecting stocks with market capitalizations greater than \$60 million but less than \$3 billion.

In December of 2006, five new small cap managers were hired in the Small Cap pool, and in January of 2007, three managers were terminated for performance reasons. The current System's Small Cap pool is invested with one Growth, one Core, and five Value managers.

The Small Cap pool return for fiscal year 2007 was 17.8% versus the benchmark's 14.9%.



# INVESTMENT SECTION

## Report on Investment Activity (Continued)

At the close of fiscal year 2007, the Small Cap pool represented 1.0% of total investments. This compares to 1.0% for fiscal year 2006. The following summarizes the System's ownership share and composition of the Small Cap Pool at September 30, 2007:

### Small Cap Value Pool (in thousands)

	Donald Smith Small Cap Value	Fisher Small Cap Value	GW Capital Small Cap Value	Northpointe Small Cap Value	Opus Capital Small Cap Value
Total Investment	\$ 2,214	\$ 2,839	\$ 1,779	\$ 2,078	\$ 598
Ownership Percentage	2.3%	2.2%	2.3%	2.5%	2.3%

### Small Cap Growth and Core Pool (in thousands)

	Champlain Small Cap Core	Pier Capital Small Cap Growth
Total Investment	\$ 1,933	\$ 2,586
Ownership Percentage	2.3%	2.3%

### S&P 500 Index Pool

The objective of the enhanced S&P 500 Index pool is to closely match the return performance of its benchmark, the S&P 500 Index, and to use low risk strategies to offset transaction costs and add to performance when possible. The pool generally holds all 500 stocks that make up the Standard & Poor's 500 Index in proportion to their weighting in the index. The following summarizes the sector weightings of the pool as of September 30, 2007:

Financials	19.8 %
Information Technology	16.2
Healthcare	11.7
Energy	11.7
Industrials	11.5
Consumer Staples	9.5
Consumer Discretionary	9.2
Telecomm. Services	3.7
Utilities	3.5
Materials	3.2
<b>Total</b>	<b><u>100.0 %</u></b>

The S&P 500 Index pool return for the fiscal year was 16.5% versus the benchmark's 16.4%.

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

At the close of fiscal year 2007, the S&P 500 Index pool represented 16.1% of total investments. This compares to 16.6% for fiscal year 2006. The following summarizes the System's 2.2% ownership share of the S&P 500 Index pool at September 30, 2007:

### S&P 500 Index Pool (in thousands)

Short Term Pooled investments	\$	2,912
Equities		212,817
Futures Contracts		5
Accrued dividends		243
<b>Total</b>	<b>\$</b>	<b>215,977</b>

### *S&P MidCap Index Pool*

The objective of the S&P MidCap Index pool is to closely match the return performance of its benchmark, the S&P MidCap, and use low risk strategies to offset transaction costs and add to performance when possible. The pool invests in equities of mid-size firms.

The S&P MidCap Index pool return for the fiscal year was 18.7% versus its benchmark's 18.8%.

At the close of fiscal year 2007, the S&P MidCap Index pool represented 1.7% of total investments. This compares to 2.0% for fiscal year 2006. The following summarizes the System's 2.1% ownership share of the S&P MidCap Index pool at September 30, 2007:

### S&P MidCap Index Pool (in thousands)

Short Term Pooled investments	\$	319
Equities		22,373
Futures Contracts		(1)
Settlement Principal Payable		(105)
Accrued dividends		15
<b>Total</b>	<b>\$</b>	<b>22,601</b>

### *International Equity Pool - Passive*

The objective of the International Equity Pool - Passive is to match the return performance of the S&P/Citigroup Broad Market Index (BMI) Europe and Pacific Composite (EPAC) adjusted for net dividends. Fifty percent of the benchmark is hedged to the U.S. Dollar and the other half is impacted by foreign currency exchange rate changes. The total passive international return for the fiscal year was 20.7% compared to the Citigroup BMI-EPAC return of 19.8%.

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

Core passive exposure to international equity returns is achieved primarily by investing in a combination of fixed income LIBOR notes, short-term fixed income investments, and equity swap agreements on foreign stock indices in developed markets. Interest on the dedicated notes and short-term fixed income investments is exchanged for international stock returns, and the total notional amount of the swap agreements is invested in the approximate proportions of the S&P/Citigroup Broad Market Index (BMI) Europe and Pacific Composite (EPAC) country weightings in related indices. Use of swap agreements for a core position began in 1993, an American Depository Receipts (ADR) and index-related security portfolio was added in June of 1999 to increase portfolio management flexibility, and a country fund portfolio with targeted capitalization was added in September of 2002 to improve exposure to the smallest companies in the BMI index.

The combination of notes, dedicated short-term investments and equity swap agreements was valued at \$88.7 million on September 30, 2007. That valuation included a net unrealized gain of \$21 million. The combined Swap agreements, notes and short-term investments together continue to perform like a stock index fund that realizes all gains and losses on a rolling three year basis. During fiscal year 2007, the pool received realized gains of \$25 million on swap equity exposures and dedicated short-term investments. During the same period, \$1.9 million of interest income was earned from international equity swaps.

At the close of fiscal year 2007, the International Equity – Passive pool represented 8.5% of total investments. This compares to 10.6% for fiscal year 2006. The following summarizes the System's 2.1% ownership share of the International Equity Pool - Passive at September 30, 2007:

### International Equity Pool - Passive (in thousands)

Short Term Pooled investments	\$	22,627
Equities		23,123
Fixed Income Securities		47,240
Market Value of Equity Contracts		20,704
Accrued dividends and interest		334
<b>Total</b>	<b>\$</b>	<b>114,028</b>

### *International Equity Pool - Active*

The investment objective is to generate a rate of return from investment in common stocks and equivalents that exceeds the S&P Citigroup Broad Market Index (BMI) World Ex-United States. That benchmark is impacted by foreign currency exchange rate changes.

In fiscal year 2005, the System invested in AllianceBernstein International Style Blend, a mix of Large Cap Growth and Value. During fiscal year 2006, investments were made in the following funds: The Wellington Trust Company International Research Equity Fund and the State Street Global Asset International Alpha Select Pool. Two international managers, SSgA Int'l Small Cap Alpha and GlobeFlex Int'l Small Cap, were selected and funded during April 2007, and added to the three managers already in the pool.

The International Equity Pool – Active return for the fiscal year was 26.5% versus the benchmark's 26.0%.

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

At the close of fiscal year 2007, the International Equity - Active pool represented 2.8% of total investments. This compares to 1.7% for fiscal year 2006. The following summarizes the System's ownership share and composition of the pool at September 30, 2007:

International Equity Pool - Active (in thousands)					
	AllianceBernstein International	Wellington International	SSGA International	Globeflex Int'l Small Cap	SSGA Int'l Small Cap
Total Investment	\$ 12,526	\$ 9,827	\$ 11,471	\$ 2,124	\$ 2,236
Ownership Percentage	2.2%	2.0%	2.0%	2.2%	2.2%

### Alternative Investments Pool

The Alternative Investments pool objective is to meet or exceed the benchmark for all private equity investments over long time periods. The benchmark is a blend of the S&P 500 Index plus 300 basis points and the 10 Year Yield plus 300 basis points using ending weights of equity and fixed income holdings within the portfolio.

Alternative Investments are investments in the private equity market, primarily through limited partnerships. The following summarizes the weightings of the pool as of September 30, 2007:

Buyout Funds	52.3 %
Special Situation Funds	16.8
Venture Capital Funds	10.9
Liquidation Portfolio	7.0
Fund of Funds	6.4
Hedge Funds	2.5
Short Term Investments	2.3
Mezzanine Funds	1.8
<b>Total</b>	<b><u>100.0 %</u></b>

The Alternative Investments pool had a return of 30.7% for the fiscal year ended September 30, 2007, versus the benchmark of 19.2%.

T. Rowe Price managed the stock distributions of the Alternative Investments beginning in October 2006. The T. Rowe Price return for the fiscal year ending September 30, 2007, was 4.8%.

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

At the close of fiscal year 2007, the Alternative Investments pool represented 14.0% of total investments and T. Rowe Price represented 0.03% of total investments. This compares to 12.7% for Alternative and 0.01% for Credit Suisse Asset Management for fiscal year 2006. The following summarizes the System's ownership share and composition of the Alternative Investments pool and T. Rowe Price at September 30, 2007:

### Alternative Investments Pool (in thousands)

	Alternative	T. Rowe Price
Short Term Pooled Investments	\$ 4,379	\$ 253
Equities	183,204	150
Settlement Proceeds Receivable		64
<b>Total</b>	<b>\$ 187,583</b>	<b>\$ 467</b>

Ownership Percentage	2.2%	1.8%
----------------------	------	------

### Real Estate Pool

The Real Estate pool seeks favorable returns primarily through rental income and appreciation of real estate investments. Real estate investments are typically held through various legal investment entities, such as limited partnerships or limited liability companies, established for the specific purpose of owning, leasing, managing, financing, or developing real estate and real estate related investments. Independent third parties regularly value the real estate investments to establish current market values.

The Real Estate pool diversifies its holdings by:

- Geography - The pool is diversified geographically with emphasis placed upon domestic (U.S.) real estate investments. The pool may also make foreign real estate investments, which are not expected to exceed 15% of the value of the pool.
- Property Size and Value - The pool diversifies its holdings so that it is not concentrated in a limited number of large real estate investments.
- Property Type - The pool is diversified by type of property as summarized in the table below.

Multi-family apartments	22.8 %
Commercial office buildings	22.3
Hotels	19.4
Retail shopping centers	14.4
Industrial warehouse buildings	7.5
Short Term Investments	5.7
Senior Living	3.3
Land	2.3
For Sale Housing	2.3
<b>Total</b>	<b>100.0 %</b>

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

The Real Estate pool generated a return of 20.5% for fiscal year 2007, while the benchmark return was 16.0%. The benchmark is the National Council of Real Estate Investment Fiduciaries Property Index less 130 basis points. During the year the pool benefited from continued strong flow of capital into the commercial real estate market from both domestic and foreign investors coupled with improvement in commercial real estate fundamentals, which resulted in the pool realizing strong appreciation and gains on asset sales.

At the close of fiscal year 2007, the Real Estate pool represented 9.7% of total investments. This compares to 8.4% for fiscal year 2006. The following summarizes the System's 2.3% ownership share of the Real Estate pool at September 30, 2007:

### Real Estate Pool (in thousands)

Short Term Pooled investments	\$ 7,382
Equities	123,035
<b>Total</b>	<b>\$ 130,417</b>

### Government Bond Pool

The objectives are to maximize the rate of return consistent with sound portfolio management principles and to outperform the Lehman Brothers Government Index.

The Government Bond Pool invests in a diversified portfolio of United States' government bonds including, but not limited to: treasuries, agencies, government sponsored enterprises and government guaranteed mortgages. To achieve above average returns, the pool emphasizes those sectors exhibiting the best risk/reward relationship relative to historical norms and the outlook for interest rates.

During the fiscal year, rates continued to be volatile. Ten-year treasuries started the year at 4.6%, rose to 5.3%, then declined and ended at 4.6%. The yield curve shifted from inverted to positively sloped. Ten to thirty-year rates remained relatively unchanged while short-term to ten-year rates declined.

For the fiscal year ending September 30, 2007, the Government Bond pool returned 5.9% which compared favorably to the 5.6% return of the Lehman Brothers Government Index.

The following summarizes the security type breakdown of the pool as of September 30, 2007:

U.S. Agency	62.8 %
GNMA	20.5
U.S. Guaranteed	11.9
Short Term Investments/Accruals	4.8
<b>Total</b>	<b>100.0 %</b>

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

At the close of fiscal year 2007, the Government Bond pool represented 8.0% of total investments. This compares to 8.3% for fiscal year 2006. The following summarizes the System's 2.2% ownership share of the Government Bond pool at September 30, 2007:

### Government Bond Pool (in thousands)

Short Term Pooled investments	\$ 4,208
Fixed Income Securities	102,620
Accrued dividends	995
<b>Total</b>	<b>\$ 107,823</b>

### *Treasury Inflation Protected Securities Pool*

A Treasury Inflation Protected Securities (TIPS) Pool was established in January 2007. Transfer of TIPS holdings in the Government Bond Pool provided the initial funding for the TIPS pool.

The TIPS pool return from inception to fiscal year end was 6.3%.

At the close of fiscal year 2007, the Treasury Inflation Protected Securities pool represented 0.4% of total investments. The following summarizes the System's 2.0% ownership share of the TIPS pool at September 30, 2007:

### TIPS Pool (in thousands)

Short Term Pooled investments	\$ 86
Fixed Income Securities	5,587
Accrued Interest	27
<b>Total</b>	<b>\$ 5,700</b>

### *Corporate Bond Pool*

The objectives are to maximize the rate of return consistent with sound portfolio management principles and to outperform the Lehman Brothers Credit Index.

The Corporate Bond Pool invests in a diversified portfolio of investment grade corporate issues. Such issues are rated in the top four categories by nationally recognized rating agencies. Non-rated issues may be acceptable if they are determined to be of comparable quality. To achieve above average returns, the pool emphasizes those sectors exhibiting the best risk/reward ratio relative to historical norms and the outlook for interest rates.

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

For the fiscal year ending September 30, 2007, the Corporate Bond pool returned 5.3% compared to the 4.2% return of the Lehman Brothers Credit Index. The pool's performance improved as the year progressed due to the decline in rates later in the year.

The following summarizes the security type breakdown of the pool as of September 30, 2007:

Financials	23.7 %
Healthcare	17.9
Industrials	13.1
Consumer Staples	11.9
Consumer Discretionary	10.3
Other	7.3
Utilities	5.5
Energy	2.7
Materials	2.6
Information Technology	2.6
Short Term Investments/Accruals	2.4
<b>Total</b>	<b><u>100.0 %</u></b>

At the close of fiscal year 2007, the Corporate Bond pool represented 5.3% of total investments. This compares to 5.8% for fiscal year 2006. The following summarizes the System's 2.1% ownership share of the Corporate Bond pool at September 30, 2007:

### Corporate Bond Pool (in thousands)

Short Term Pooled investments	\$ 831
Fixed Income Securities	68,861
Accrued dividends	837
<b>Total</b>	<b><u>\$ 70,529</u></b>

### *Fixed Income Core Pools*

Five Fixed Income Core managers were selected in fiscal year 2006, beginning March 31, 2006. Their objective is to generate a rate of return exceeding the Lehman Aggregate Index net of fees.

Delaware Investments, Dodge & Cox, Dupont Capital Management, Pyramis Global Advisors, and Metropolitan West Asset Management were the firms hired.

The Fixed Income Core pools combined rate of return for the fiscal year was 5.3% versus the benchmark's 5.1%.

At the close of fiscal year 2007, the Fixed Income Core pools represented 1.4% of total investments. This compares to 1.0% for fiscal year 2006. The following summarizes the System's ownership share and composition of the five Fixed Income Core pools at September 30, 2007:



# INVESTMENT SECTION

## Report on Investment Activity (Continued)

### Fixed Income Core Pools (in thousands)

	Delaware Fixed Income Core	Dodge & Cox Fixed Income Core	Dupont Fixed Income Core	Pyramis Fixed Income Core	Metro West Fixed Income Core
Total Investment	\$ 2,369	\$ 4,064	\$ 2,888	\$ 5,810	\$ 4,097
Ownership Percentage	2.2%	2.2%	2.2%	2.2%	2.2%

### *Fixed Income Corporate Manager Pools*

Four fixed income corporate managers were selected and commenced management on September 15, 2006, with an objective of exceeding the return of the Lehman Credit Index net of fees.

The four managers hired were AllianceBernstein, Prudential Financial, Western Asset, and Taplin, Canida & Habacht.

The Fixed Income Corporate Manager pools combined rate of return for the fiscal year was 4.7% versus the benchmark's 4.2%.

At the close of fiscal year 2007, the Fixed Income Corporate Manager pools represented 1.2% of total investments. This compares to 0.9% for fiscal year 2006. The following summarizes the System's ownership share and composition of the four Fixed Income Corporate Manager pools at September 30, 2007:

### Fixed Income Corporate Manager Pools (in thousands)

	Alliance Bernstein Corporate	Prudential Financial Corporate	Western Asset Corporate	Taplin, Canida & Habacht Corporate
Total Investment	\$ 3,410	\$ 5,161	\$ 3,399	\$ 3,387
Ownership Percentage	2.2%	2.2%	2.2%	2.2%

### *Short Term Investment Pool*

The objective of the Short Term Investment pool is to closely match the return performance of its benchmark, the 30 day Treasury bill. The Short Term Investment pool return for the fiscal year was 5.4% versus the benchmark's 4.9%.

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

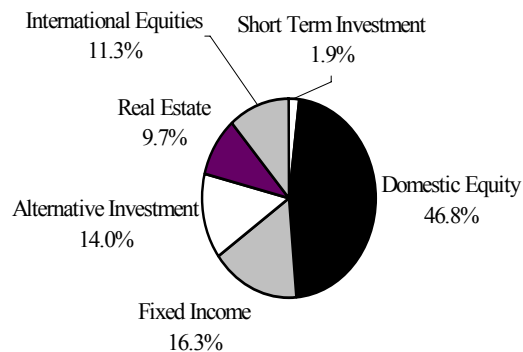
Potential areas of investment are:

- Obligations of the United States or its agencies.
- Bankers' acceptances, commercial accounts, certificates of deposit or depository receipts.
- Repurchase agreements for the purchase of securities issued by the US government or its agencies.
- Commercial paper rated at the time of purchase within the two highest classifications established by not less than two national rating services as determined by the State Treasurer.

As of September 30, 2007, the Short Term Investment pool was 100% invested in commercial paper because of its advantages in yield and flexibility in maturities.

At the close of fiscal year 2007, the Short Term Investment pool represented 1.9% of total investments. This compares to 2.1% for fiscal year 2006. The System's ownership share of the Short Term Investment pool at September 30, 2007 was \$25,661,725 composed of fixed income securities and equity in common cash.

### Asset Allocation – Security Type



# INVESTMENT SECTION

## Investment Results for the Period Ending September 30, 2007

Investment Category	Current Year	Annualized Rate of Return <sup>1</sup>		
		3 Years	5 Years	10 Years
Total Portfolio	17.4 %	14.4 %	14.0 %	8.1 %
Total Domestic Equity	16.7	13.1	15.6	7.1
S&P 1500 Index	16.6	13.4	15.8	7.0
Large Cap Value Pool	13.7	14.1		
Large Cap Growth Pool	19.8	11.7		
Mid Cap Pool	22.6			
Small Cap Pool	17.8	14.2		
S&P 500 Index Pool	16.5	13.2		
S&P MidCap Index Pool	18.7	15.8		
International Equity Pool - Passive	20.7	21.8	21.3	8.4
S&P Citigroup BMI - EPAC 50/50	19.8	22.5	21.6	8.1
International Equity Pool - Active	26.5			
Alternative Investments Pool	30.7	26.2	19.9	13.3
Alternative Blended Benchmark <sup>2</sup>	19.2	16.1	18.6	10.0
T. Rowe Price (Stock Distributions)	4.8			
Real Estate Pool	20.5	17.9	13.5	12.1
NCREIF Property Blended Index <sup>3</sup>	16.0	16.9	13.8	12.2
Total Fixed Income	5.6	4.1	4.2	5.7
Lehman Brothers Government/Credit	5.1	3.7	4.2	6.0
Government Bond Pool	5.9	4.5		
Corporate Bond Pool	5.3	3.7		
Fixed Income Core Pool	5.3			
Fixed Income Managers Pool	4.7			
Short Term Investment Pool	5.4	4.1	3.0	4.0
30 Day Treasury Bill	4.9	3.9	2.8	3.5

<sup>1</sup> Calculations used a time-weighted rate of return based on the market rate of return in accordance with industry standards.

<sup>2</sup> As of 1/1/07, index is blend of S&P 500 plus 300 bps and 10 year yield plus 300 bps based on ending weights.

History prior to 1/1/07 is S&P 500 plus 300 bps.

<sup>3</sup> As of 10/1/05, index is NCREIF less 130 bps. History prior to 10/1/05 reflects NCREIF less 75 bps.

# INVESTMENT SECTION

## Largest Assets Held

### **Largest Stock Holdings (By Market Value)<sup>1</sup> September 30, 2007**

<b>Rank</b>	<b>Shares</b>	<b>Stocks</b>	<b>Market Value</b>
1	165,170	Exxon Mobil Corporation	\$ 15,288,162
2	356,903	General Electric Corporation	14,775,788
3	85,153	SPDR Trust	12,992,603
4	433,217	Microsoft Corporation	12,762,565
5	181,000	American International Group	12,244,616
6	242,943	Citigroup Incorporated	11,338,147
7	167,730	Johnson and Johnson	11,019,830
8	141,909	Procter and Gamble Corporation	9,981,871
9	99,008	Chevron Corporation	9,265,124
10	274,370	Cisco Systems Inc	9,084,389

### **Largest Bond Holdings (By Market Value)<sup>1</sup> September 30, 2007**

<b>Rank</b>	<b>Par Amount</b>	<b>Description</b>	<b>Market Value</b>
1	\$ 5,320,340	General Electric Cap Corp 5.7275% FRN Due 2-15-2017	\$ 5,200,398
2	3,981,040	Treasury Inflation Index Due 7-15-14	4,338,454
3	4,298,040	Bank Nova Scotia 5.37% FRN Due 10-12-2007	4,298,375
4	4,285,296	Wachovia Corp 5.28125% FRN Due 4-23-2012	4,248,335
5	3,223,530	HSBC Finance Corp 5.46% FRN Due 10-22-2007	3,224,194
6	3,223,530	JP Morgan Chase & Co 5.7375% FRN Due 9-21-2012	3,210,920
7	2,256,471	American Honda Finance 5.25% FRN Due 1-22-2008	2,256,891
8	2,149,020	First Tennessee Bank 5.41% FRN Due 11-7-2008	2,153,245
9	2,149,020	American Honda Finance 5.74313% FRN Due 3-13-2008	2,150,782
10	2,149,020	HBOS PLC 5.70313% FRN Due 3-14-2008	2,149,914

<sup>1</sup> A complete list of holdings is available from the Michigan Department of Treasury.

The Plan's assets are commingled in various pooled accounts. Amounts, par value, and number of shares represent the System's pro-rata share based on its ownership of the investment pools.

# INVESTMENT SECTION

## Schedule of Investment Fees

The State Treasurer is the investment fiduciary and custodian of the System's funds pursuant to State law. Outside advisors are utilized to augment the State Treasurer's internal staff. Only 31.2% of the total investment portfolio is managed by fully discretionary outside advisors. The Michigan Department of Treasury's cost of operations applicable to the retirement system for the fiscal year end amounted to \$240 thousand or two and six tenths basis points (.026%) of the market value of the Assets under Management by the State Treasurer.

Act 380 of the Public Acts of 1965 created an Investment Advisory Committee (Committee) comprised of the directors of the Department of Labor and Economic Growth and the Department of Management and Budget, or their duly authorized representatives, and three public members appointed by the Governor with the advice and consent of the Senate. The public members serve without pay, but may be paid actual and necessary travel and other expenses. The Committee meets quarterly to review investments, goals and objectives and may submit recommendations to the State Treasurer. The Committee may also, by a majority vote, direct the State Treasurer to dispose of any holding, which in the Committee's judgment is not suitable for the fund involved, and may by unanimous vote direct the State Treasurer to make specific investments.

### Schedule of Investment Fees

#### *Investment Managers' Fees:*

	<b>Assets under Management (in thousands)</b>	<b>Fees (in thousands)</b>	<b>Basis Points *</b>
State Treasurer	\$ 923,689	\$ 240	2.6
Outside Advisors -			
Fixed Income	34,585	42	12.1
Mid Cap Equity	30,750	154	50.1
Small Cap Equity	14,028	97	69.1
International Equity	60,081	110	18.3
Alternative	183,383	1,415	77.2
Real Estate	96,250	103	10.7
<b>Total</b>	<b>\$ 1,342,766</b>	<b>\$ 2,161</b>	

#### *Other Investment Services Fees:*

Custody & Research Fees	\$ 1,317,105	\$ 54
Security Lending Fees	275,481	98

\* Outside Advisors Fees are netted against income for Fixed Income, Small Cap, Mid Cap Equity, and International Equity. For Alternative partnership agreements that define the management fees, the asset management fees range from 100 on remaining assets under management to 250 basis points of the committed capital. For Real Estate, the asset management fee ranges from 50 to 175 basis points. Alternative and Real Estate fees, in most cases, are netted against income.

# INVESTMENT SECTION

## Schedule of Investment Commissions

	Fiscal Year Ended September 30, 2007						
	Actual	Actual	Average	Estimated	Estimated	Estimated	Estimated
	Commissions	Number of	Commission	Trade	Research	Trade	Research
	Paid <sup>(1)</sup>	Shares Traded <sup>(1)</sup>	Rate Per Share	Costs Per Share	Costs Per Share	Costs	Costs
<b>Investment Brokerage Firms:</b>							
Banc of America Securities LLC	\$ 659	21,951	\$ 0.03	\$ 0.01	\$ 0.02	\$ 220	\$ 439
Bear, Stearns & Co Inc	15,914	775,064	0.02	0.01	0.01	7,751	8,163
Broadcort Capital	2,691	89,692	0.03	0.01	0.02	897	1,794
Cantor Fitzgerald & Co.	5,246	210,269	0.02	0.01	0.01	2,103	3,143
Citigroup Global Markets Inc	14,860	488,991	0.03	0.01	0.02	4,890	9,970
Cowen & Co, LLC	6,496	216,543	0.03	0.01	0.02	2,165	4,331
Credit Suisse Securities LLC	14,001	482,896	0.03	0.01	0.02	4,829	9,172
Deutsche Bank Securities Inc	5,702	189,177	0.03	0.01	0.02	1,892	3,810
Goldman, Sachs & Co	11,174	372,421	0.03	0.01	0.02	3,724	7,450
The Griswold Company Incorporated	4,131	206,529	0.02	0.01	0.01	2,065	2,065
Investment Technology Group Inc	4	366	0.01	0.01	-	4	1
ISI Capital LLC	3,139	101,546	0.03	0.01	0.02	1,015	2,124
J P Morgan Securities Inc	6,497	215,372	0.03	0.01	0.02	2,154	4,343
Labranche Financial Services Inc (MARA)	786	38,767	0.02	0.01	0.01	388	399
Lehman Brothers Inc	8,807	293,424	0.03	0.01	0.02	2,934	5,873
Liquidnetinc	4	192	0.02	0.01	0.01	2	2
Merrill Lynch, Pierce, Fenner & Smith, Inc	20,722	681,177	0.03	0.01	0.02	6,812	13,910
Mischler Financial Group, Inc	671	22,381	0.03	0.01	0.02	224	448
Morgan Stanley	10,994	366,462	0.03	0.01	0.02	3,665	7,329
OTA LLC	1,140	37,989	0.03	0.01	0.02	380	760
Prudential Equity Group LLC	4,399	146,628	0.03	0.01	0.02	1,466	2,933
Punk, Ziegel & Company	2,471	82,371	0.03	0.01	0.02	824	1,647
Sanford C. Bernstein & Co LLC	9,646	321,518	0.03	0.01	0.02	3,215	6,430
Stanford Group Co	1,697	54,094	0.03	0.01	0.02	541	1,156
State Street Brokerage Services	40,635	3,562,330	0.01	0.01	-	35,623	5,012
Thinkequity Partners LLC	71	1,914	0.04	0.01	0.03	19	52
Thomas Weisel Partners	813	21,396	0.04	0.01	0.03	214	599
UBS Securities LLC	9,281	309,377	0.03	0.01	0.02	3,094	6,188
Wachovia Capital Markets, LLC	5	183	0.03	0.01	0.02	2	4
Wayne Company	392	11,990	0.03	0.01	0.02	120	273
Weeden & Co	1,782	178,238	0.01	0.01	-	1,782	-
	<u>\$ 204,830</u>	<u>9,501,248</u>	<u>\$ 0.03 <sup>(2)</sup></u>	<u>\$ 0.01</u>	<u>\$ 0.02</u>	<u>\$ 95,014</u>	<u>\$ 109,820</u>

<sup>(1)</sup> Commissions are included in purchase and sale prices of investments. The commissions and shares represent the System's pro-rata share of commission and share transactions based on ownership in the investment pools.

<sup>(2)</sup> The average commission rate per share for all brokerage firms.

# INVESTMENT SECTION

## Investment Summary

Fiscal Year Ended September 30, 2007

	Market Value (a)	Percent of Total Market Value	Investment & Interest Income (b)	Percent of Investment & Interest Income
Fixed Income Pools	\$ 218,636,688	16.3%	\$ 11,224,437	5.5%
Domestic Equity Pools	627,788,771	46.8%	92,507,419	45.6%
Real Estate Pool	130,416,859	9.7%	21,131,262	10.4%
Alternative Investment Pools	188,050,550	14.0%	46,219,137	22.8%
International Equities Pools	152,211,843	11.3%	30,453,966	15.0%
Short Term Investment Pools	25,661,725	1.9%	1,450,686	0.7%
<b>Total</b>	<b>\$ 1,342,766,436</b>	<b>100.0%</b>	<b>\$ 202,986,907</b>	<b>100.0%</b>

(a) Market value excludes \$282,596,545 in cash collateral for security lending for fiscal year 2007.

(b) Total Investment & Interest Income excludes net security lending income of \$521,962.

# INVESTMENT SECTION

## Investment Summary (Continued)

Fiscal Year Ended September 30, 2006

	Market Value (a)	Percent of Total Market Value	Investment & Interest Income (b)	Percent of Investment & Interest
Fixed Income Pools	\$ 192,055,307	16.0%	\$ 7,496,917	5.3%
Domestic Equity Pools	582,758,980	48.5%	56,732,354	39.9%
Real Estate Pool	100,633,124	8.4%	17,165,248	12.1%
Alternative Investment Pool	152,186,251	12.7%	34,464,991	24.3%
International Equities Pools	147,922,103	12.3%	24,866,448	17.5%
Short Term Investment Pools	25,907,367	2.1%	1,239,479	0.9%
<b>Total</b>	<u><u>\$ 1,201,463,132</u></u>	<u><u>100.0%</u></u>	<u><u>\$ 141,965,437</u></u>	<u><u>100.0%</u></u>

(a) Market value excludes \$187,448,116 in cash collateral for security lending for fiscal year 2006.

(b) Total Investment & Interest Income excludes net security lending income of \$165,057.



# ACTUARIAL SECTION

Actuary's Certification  
Summary of Actuarial Assumptions and Methods  
Schedule of Active Member Valuation Data  
Retirant and Beneficiary Data  
Prioritized Solvency Test  
Analysis of System Experience  
Summary of Plan Provisions

# ACTUARIAL SECTION

## Actuary's Certification



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October 10, 2007

Ms. Lisa Webb Sharpe, Director  
Department of Management and Budget  
and  
The Retirement Board  
Michigan State Police Retirement System  
P.O. Box 30171  
Lansing, Michigan 48909

Ladies and Gentlemen:

The basic financial objective of the Michigan State Police Retirement System (SPRS) is to establish and receive contributions which when combined with present assets and future investment return will be sufficient to meet the financial obligations of the system to present and future benefit recipients.

The financial objective is addressed within the actuarial valuation. The valuation process develops employer contributions that are sufficient to fund the plan's normal cost (i.e., the costs assigned by the valuation method to the year of service about to be rendered), as well as to fund any unfunded accrued liabilities over a reasonable period. The most recent valuation was completed based upon population data, asset data, and plan provisions as of September 30, 2006.

The Retirement System provides the actuary with data for the actuarial valuation. The actuary relies on the data after reviewing it for internal and year to year consistency. The actuary summarizes and tabulates population data in order to analyze long term trends. The plan's external auditor also audits the actuarial data annually.

Annual actuarial valuations are based upon assumptions regarding future activity in specific risk areas including the rate of investment return and payroll growth, eligibility for the various classes of benefits and longevity among retired lives. These assumptions are adopted by the Board and the Department after considering the advice of the actuary and other professionals. The assumptions and the methods comply with the requirements of GASB Statement No. 25. Each actuarial valuation takes into account all prior differences between actual and assumed experience in each risk area and adjusts the contribution rates as needed.

## Actuary's Certification (continued)

Ms. Lisa Webb Sharpe

October 10, 2007

Page 2

Our firm provided the following supporting schedules for use in the Comprehensive Annual Financial Report:

### Financial Section

- Note 1 Table of System's Membership
- Schedule of Funding Progress
- Schedule of Employer Contributions (Annual Required Contribution)
- Note B - Summary of Actuarial Assumptions

### Actuarial Section

- Summary of Actuarial Assumptions and Methods
- Percent of Eligible Active Members Retiring Within Next Year
- Separation from Active Employment Before Age and Service Retirement and Individual Pay Increase Assumptions
- Schedule of Active Member Valuation Data
- Schedule of Retirant and Beneficiary Data
- Prioritized Solvency Test
- Analysis of System Experience

### Statistical Section

- Schedule of Retired Members by Type of Pension Benefit (Retirement Type and Option)
- Schedule of Average Benefit Payments - Pension

The actuarial valuation of SPRS as of September 30, 2006 was performed by qualified actuaries in accordance with standards of practice prescribed by the Actuarial Standards Board and in compliance with applicable state statutes. It is our opinion that the calculated employer contribution meets the financial objective of the Retirement System.

Respectfully submitted,



James Koss, ASA, MAAA



Alan Sonnanstine, ASA, MAAA

WJK/AES:lr

Gabriel Roeder Smith & Company

# **ACTUARIAL SECTION**

## **Summary of Actuarial Assumptions and Methods**

1. The investment return rate used in the valuations was 8% per year net of expenses, compounded annually. This rate of return is not the assumed real rate of return. Considering other financial assumptions, this 8% investment return rate translates to an assumed real rate of return of 4.5%. Adopted 2004.
2. The healthy life mortality table used in evaluating allowances to be paid was the 1994 Group Annuity Mortality Table. Adopted 2004.
3. Sample probabilities of retirement with an age and service allowance are shown in Schedule 1 on the next page. Adopted 2004.
4. Sample probabilities of withdrawal from service and disability, together with individual pay increase assumptions, are shown in Schedule 2 on the next page. Adopted 2004.
5. Total active member payroll is assumed to increase 3.5% per year. This represents the portion of the individual pay increase assumptions attributable to inflation. In effect, this assumes no change in the number of active members. Adopted 1998.
6. An individual entry age actuarial cost method of valuation was used in determining age and service allowance actuarial liabilities and normal cost. Unfunded actuarial accrued liabilities, including actuarial gains and losses, are financed over a declining 40-year period beginning October 1, 1996. Adopted or re-adopted 1996.
7. The Department of Management and Budget approved the use of market value of assets as of September 30, 2006, for actuarial valuation purposes. For investment gains or losses that occur after that date, a 5-year smoothing technique will be used. Specifically, the excess (shortfall) of actual investment income (including interest, dividends, realized and unrealized gains or losses) over the imputed income at the valuation interest rate is considered the gain (loss), which is spread over 5 years. Adopted 2007.
8. The data about persons now covered and about present assets was furnished by the System's administrative staff. Although examined for general reasonableness, the data were not audited by the actuary.
9. The actuarial valuation computations were made by or under the supervision of a Member of the American Academy of Actuaries (MAAA). The assumptions used in the actuarial valuations were adopted by the System's Board and the Department of Management and Budget after consulting with the actuary.
10. A 5-year experience investigation, covering the period from September 30, 1997, through September 30, 2002, was completed in April 2004. The purpose of the study was to analyze the actual experience of the System versus that anticipated by the actuarial assumptions then in use. The combined effect of the recommended changes in assumptions was an increase in actuarial accrued liabilities of approximately 0.1% and an 8.3% decrease in computed employer contributions. Adopted 2004.
11. Gabriel Roeder Smith & Company was awarded the actuarial and consulting services contract beginning October 4, 2006.
12. Election of two person retiree health coverage is assumed to be 85% for males and 70% for females depending on participant type.
13. A retiring member electing coverage for a surviving beneficiary or spouse (active and inactive members) is assumed to be 85% of male retirees and 70% of female retirees.
14. Six percent of pension recipients will opt-out of the retiree health care plan.

# ACTUARIAL SECTION

## Summary of Actuarial Assumptions and Methods (Continued)

### SCHEDULE 1

#### Percent of Eligible Active Members Retiring Within Next Year <sup>(1)</sup>

<u>Retirement Ages</u>	
<b>First year eligible to retire</b>	
49 and under	50 %
<b>After first year eligible to retire</b>	
46 and under	35
47	25
48-49	25
<b>All Members</b>	
50-51	20
52-60	25
61	50
62	70
63 and over	100

(1) Of those assumed to retire with 25 or more years of service, based on the percents above, 90% are assumed to elect the DROP and 10% are assumed to retire without DROP.

### SCHEDULE 2

#### Separation From Active Employment Before Age & Service Retirement & Individual Pay Increase Assumptions

<u>Sample Ages</u>	<u>Years of Service</u>	<u>Percent of Active Members Withdrawing Within Next Year (Men and Women)</u>	<u>Percent of Active Members Becoming Disabled Within Next Year</u>		<u>Percent Increase In Pay During Next Year</u>
All	0	6.50 %			93.50 %
	1	5.00			21.50
			<u>Duty</u>	<u>Non-duty</u>	
20	2 & Over	2.00	0.25 %	0.00 %	9.92
25	"	2.00	0.25	0.00	9.40
30	"	1.50	0.25	0.01	6.60
35	"	0.60	0.25	0.02	5.26
40	"	0.35	0.25	0.05	4.54
45	"	0.35	0.25	0.11	4.28
50	"	0.35	0.25	0.19	4.22
55	"		0.25	0.27	4.02
60 & Over	"		0.25	.038	4.02

# ACTUARIAL SECTION

## Actuarial Valuation Data

### Schedule of Active Member Valuation Data

<b>Valuation Date Sept. 30</b>	<b>Number</b>	<b>Reported Annual Payroll</b>	<b>Average Annual Pay</b>	<b>% Increase</b>	<b>Average Age</b>	<b>Average Service</b>
1997	2,090	\$ 110,085,960	\$ 52,673	5.3 %	38.2	12.9
1998	2,220	108,183,040	48,731	(7.5)	37.5	11.6
1999	2,216	116,910,216	52,757	8.3	37.0	11.5
2000	2,210	116,558,417	52,741	(0.0)	37.2	11.6
2001	2,137	118,788,227	55,586	5.4	37.9	12.2
2002	2,048	124,366,038	60,726	9.3	38.5	12.8
2003	1,848	113,201,430	61,256	0.9	38.3	12.5
2004	1,831	119,721,613	65,386	6.7	38.1	11.8
2005	1,708	117,648,748	68,881	5.3	38.3	12.0
2006	1,678	115,894,652	69,067	0.3	39.2	12.9

Excludes DROP program participants who are still actively employed.

### **Retirant and Beneficiary Data** Rolls End of Year

<b>Year Ended Sept. 30</b>	<b>Number</b>			<b>Average Monthly Benefit</b>			<b>Average Age</b>		
	<b>Pensioners <sup>(1)</sup></b>	<b>Widows</b>	<b>Children</b>	<b>Pensioners</b>	<b>Widows</b>	<b>Children</b>	<b>Pensioners</b>	<b>Widows</b>	<b>Children</b>
1997	1703	310	5	\$ 1,963	\$ 1,192	\$ 419	62.5	70.4	10.7
1998	1,820	314	5	2,062	1,225	499	62.8	71.0	10.1
1999	1,893	334	4	2,141	1,263	499	63.1	71.5	10.8
2000	1,968	345	6	2,227	1,308	366	61.9	71.9	10.4
2001	2,023	353	6	2,298	1,357	366	62.5	73.3	11.4
2002	2,095	361	6	2,378	1,415	366	62.6	72.7	16.3
2003	2,280	364	5	2,506	1,464	419	62.2	73.1	16.3
2004	2,167	313	8	2,609	1,502	475	62.8	73.5	17.5
2005	2,182	379	8	2,747	1,562	511	63.1	74.2	11.5
2006	2,152	400	10	2,808	1,661	540	63.7	74.1	11.9

<sup>(1)</sup> Does not include alternate payees

## Prioritized Solvency Test

The System's funding objective is to meet long term benefit promises through contributions that remain approximately level from year to year as a percent of member payroll. If the contributions to the System are level in concept and soundly executed, the System will pay all promised benefits when due, the ultimate test of financial soundness. Testing for level contribution rates is the long-term solvency test.

A prioritized solvency test is another means of checking a system's progress under its funding program. In a short condition test, the plan's present assets (cash and investments) are compared with: (1) active member contributions on deposit; (2) the liabilities for future benefits to present retired lives; and (3) the liabilities for service already rendered by active and inactive members. In a system that has been following the discipline of level percent of payroll financing, the liabilities for active member contributions on deposit (liability 1) and the liabilities for future benefits to present retired lives (liability 2) will be fully covered by present assets (except in rare circumstances). In addition, the liabilities for service already rendered by active members (liability 3) is normally partially covered by the remainder of present assets. Generally, if the System has been using level-cost financing, the funded portion of liability 3 will increase over time. Liability 3 being fully funded is not necessarily a by-product of level percent of payroll funding methods.

The schedule below illustrates the history of the liabilities of the System and is indicative of the System's policy of following the discipline of level percent of payroll financing.

(\$ in thousands)

Valuation Date Sept. 30	Actuarial Accrued Liability (AAL)			Valuation Assets	Portion of (AAL) Covered by Assets			
	(1)	(2)	(3)		(1)	(2)	(3)	(4) <sup>3</sup>
	Active Member Contributions	Retirants and Beneficiaries	Active and Inactive Members (Employer Financed Portion)					
1997	\$ 847	\$ 516,379	\$ 363,100	\$ 787,240	100 %	100 %	74.4 %	89.4 %
1997 <sup>1</sup>	847	516,379	363,100	928,714	100	100	113.3	105.5
1997 <sup>2</sup>	847	516,379	395,533	928,714	100	100	104.0	101.7
1998	614	593,169	349,941	974,365	100	100	108.8	103.2
1998 <sup>3</sup>	614	604,724	357,130	974,365	100	100	103.3	101.2
1999	464	643,284	362,780	1,036,840	100	100	108.4	103.0
2000	383	685,272	355,059	1,113,065	100	100	120.3	107.0
2001	368	717,244	356,021	1,148,609	100	100	121.1	107.0
2002	329	759,929	375,400	1,141,348	100	100	101.5	100.5
2003	240	861,504	324,666	1,139,138	100	100	85.4	96.0
2004 <sup>4</sup>	217	894,962	360,646	1,117,704	100	100	61.7	89.0
2005	295	909,741	390,307	1,090,327	100	100	46.1	83.7
2006	268	981,994	403,591	1,113,455	100	100	32.5	80.3
2006 <sup>1</sup>	268	981,994	403,591	1,204,248	100	100	55.0	86.9

<sup>1</sup> Revised asset valuation method.

<sup>2</sup> Change in assumptions and benefit provisions.

<sup>3</sup> Percent funded on a total valuation asset and total actuarial accrued liability basis.

<sup>4</sup> Change in assumptions and benefit provisions.

# ACTUARIAL SECTION

## Analysis of System Experience

### **Gains/(Losses) in Accrued Liabilities During Year Ended September 30, 2006 Resulting from Differences Between Assumed Experience & Actual Experience**

<u>Type of Activity</u>	<u>Gain/(Loss)</u>
1. <b>Retirements (including Disability Retirement).</b> If members retire at older ages or with lower final average pay than assumed, there is a gain. If younger ages or higher average pays, a loss.	\$ 1,676,993
2. <b>Withdrawal From Employment</b> (including death-in-service). If more liabilities are released by withdrawals and deaths than assumed, there is a gain. If smaller releases, a loss.	183,394
3. <b>Pay Increases.</b> If there are smaller pay increases than assumed, there is a gain. If greater increases, a loss.	15,188,373
4. <b>Investment Income.</b> If there is greater investment income than assumed, there is a gain. If less income, a loss.	(5,382,827)
5. <b>Death After Retirement.</b> If retirants live longer than assumed, there is a loss. If not as long, a gain.	4,007,875
6. <b>New entrants/rehires.</b> New entrants into the System will generally result in an actuarial loss.	(311,148)
7. <b>Other.</b> Miscellaneous gains and losses resulting from data adjustments, timing of financial transactions, etc.	<u>(7,924,377)</u>
8. <b>Composite Gain (or Loss) During Year</b>	<u><u>\$ 7,438,283</u></u>



## Summary of Plan Provisions

Our actuarial valuation of the System as of September 30, 2006, is based on the present provisions of Public Act 182 of 1986, as amended.

### ***Regular Retirement***

Eligibility - 25 years of credited service with no age requirement; or age 50 with 10 years credited service.

Annual Amount - If member has 25 or more years of credited service, 60% of final average compensation; if member has less than 25 years of credited service, total credited service times 2% of final average compensation.

Type of Final Average Compensation - Average of 2 final years.

### ***Early Retirement***

None.

### ***Deferred Retirement (vested benefit)***

Eligibility - 10 years of credited service. Benefit commences at age 50.

Annual Amount - Computed as Regular Retirement benefit based on credited service and final average compensation at termination.

### ***Duty-Disability Retirement***

Eligibility - No age or service requirement.

Annual Amount - 60% of final average compensation. Disability benefit plus workers' compensation benefit, if any, shall not exceed 100% of final average compensation.

### ***Non-Duty Disability Retirement***

Eligibility - 10 years of credited service.

Annual Amount - 2.4% of final average compensation times years of credited service, to a maximum of 60% of final average compensation.

### ***Duty Death Before Retirement***

Eligibility - No age or service requirement.

Annual Amount - 60% of final average compensation is payable to surviving spouse; additional \$1,200 per year for each child under 18 is also payable. If no surviving spouse, children under 18 share in 60% benefit until attainment of age 18. If no spouse or children, dependent parents are eligible for 60% benefit (plus \$1,200 per dependent sibling under 18). Retirement benefit plus workers' compensation, if any, shall not exceed 100% of final average compensation.

Lump Sum Payment - A \$1,500 funeral benefit is also payable.

# ***ACTUARIAL SECTION***

## **Summary of Plan Provisions (Continued)**

### ***Non-Duty Death Before Retirement***

Eligibility - 10 years of credited service.

Annual Amount - 2.4% of final average compensation times years of credited service, to a maximum of 60% of final average compensation, payable to surviving spouse. If no surviving spouse, children under 18 share in benefit until attainment of age 18.

### ***Death After Retirement***

The retired member's benefit continues to the surviving spouse. If no surviving spouse, children under 18 share in the continued benefit until attainment of age 18.

### ***DROP Program Provisions***

DROP Eligibility - Any age with 25 years of service.

Maximum Years of DROP - 6 years.

Retirement Benefit - Monthly benefit frozen at date of DROP election.

DROP Account – Amount credited – 100% of the participant's Retirement Benefit if stay full six years (for all 6 years); 90% if stay 5 years; 80% if stay 4 years; 70% if stay 3 years; 60% if stay 2 years; 50% if stay 1 year; 30% if stay less than 1 year.

Interest Credit Rate - 3%

COLA - No COLA adjustment on Retirement Benefit until the end of the DROP period.

Benefit Options - At termination of DROP participation and commencement of retirement, options are lump sum of DROP account, partial lump sum, or maintain funds in account.

### ***Post-Retirement Cost-of-Living Adjustments***

All members retiring (or leaving employment with vested benefits), and their survivors, are eligible for automatic 2% annual (non-compounded) benefit increases, with a maximum annual increase of \$500.

### ***Post-Retirement Health Insurance Coverage***

Persons in receipt of retirement allowances, and their dependents, are eligible for 95% State-paid health insurance coverage and 90% State-paid dental and vision insurance.

### ***Member Contributions***

None.

# STATISTICAL SECTION

Schedules of Revenues by Source  
Schedules of Expenses by Type  
Schedules of Changes in Net Assets  
Schedules of Benefits and Refunds by Type  
Schedules of Retired Members by Type of Benefit  
Schedules of Average Benefit Payments  
Ten Year History of Membership

# STATISTICAL SECTION

This part of the System's comprehensive annual financial report presents detailed information as a context for understanding what the information in the financial statements, note disclosures, and required supplementary information says about the System's overall financial health.

## Contents

### *Financial Trends*

These schedules contain trend information to help the reader understand how the System's financial performance and fiscal health has changed over time. The schedules are presented for the last ten fiscal years. Schedules included are:

- Schedule of Pension Plan Revenues by Source
- Schedule of Health Plan Revenues by Source
- Schedule of Pension Plan Expenses by Type
- Schedule of Health Plan Expenses by Type
- Schedule of Changes in Net Assets – Pension Plan
- Schedule of Changes in Net Assets – Health Plan
- Schedule of Pension Benefits and Refunds by Type
- Schedule of Health Benefits and Refunds by Type

### *Operating Information*

These schedules contain contextual information to assist the reader's understanding of how the System's financial information relates to the combination of participating members and the benefits it provides. The schedules are presented for the last ten fiscal years, except where noted. Schedules included are:

- Schedule of Retired Members by Type of Pension Benefit
- Schedule of Retired Members by Type of Health Benefit
- Schedule of Average Benefit Payments—Pension
- Schedule of Average Benefit Payments—Health
- Schedule of Average Benefit Payments—Dental
- Schedule of Average Benefit Payments—Vision
- Ten Year History of Membership

# STATISTICAL SECTION

## Schedule of Pension Plan Revenues by Source

Last Ten Years

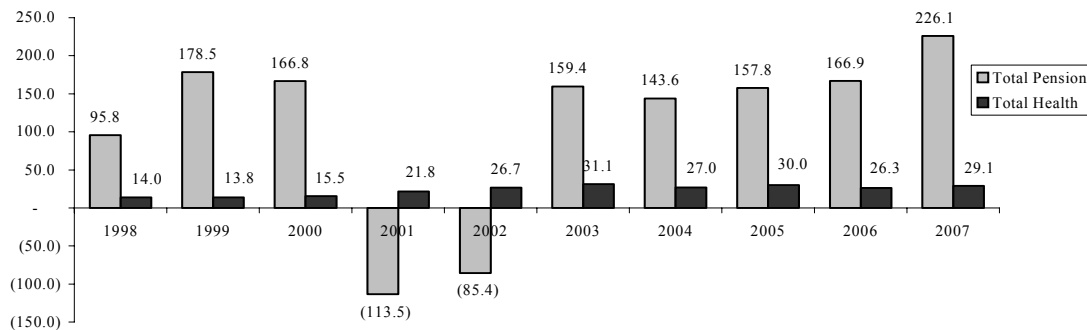
Fiscal Year Ended Sept. 30	Member Contributions	Employer Contributions		Net Investment & Other Income	Total
		Dollars	% of Annual Covered Payroll		
1998	\$ 38,727	\$ 20,003,807	18.5 %	\$ 75,726,277	\$ 95,768,811
1999	7,679	21,609,520	18.5	156,896,728	178,513,927
2000	16,793	22,107,292	19.0	144,657,843	166,781,928
2001	197,234	24,064,039	20.3	(137,798,523)	(113,537,250)
2002	113,114	22,456,469	18.1	(108,017,248)	(85,447,665)
2003	78,111	25,931,762	22.9	133,377,555	159,387,428
2004	30,062	24,792,137	20.7	118,817,294	143,639,493
2005	112,303	26,607,572	22.6	131,111,123	157,830,998
2006	252,805	26,103,923	22.5	140,565,537	166,922,265
2007	101,205	24,323,324	N/A	201,660,589	226,085,118

## Schedule of Health Plan Revenues by Source

Last Ten Years

Fiscal Year Ended Sept. 30	Member Contributions	Employer Contributions		Net Investment & Other Income	Total
		Dollars	% of Annual Covered Payroll		
1998	\$ 884,009	\$ 13,119,577	12.1 %		\$ 14,003,586
1999	992,839	12,838,366	11.0		13,831,205
2000	1,098,440	14,421,517	12.4		15,519,957
2001	1,265,408	20,581,979	17.3		21,847,387
2002	1,380,199	25,270,639	20.3		26,650,838
2003	1,501,196	29,620,331	26.2		31,121,527
2004	1,572,372	25,426,780	21.2		26,999,152
2005	1,566,646	28,488,384	24.2		30,055,030
2006	1,254,352	25,021,287	21.6	\$ 4,319	26,279,958
2007	1,219,760	27,840,439	N/A		29,060,199

**Total Revenue**  
Year Ended September 30  
(in millions)



# STATISTICAL SECTION

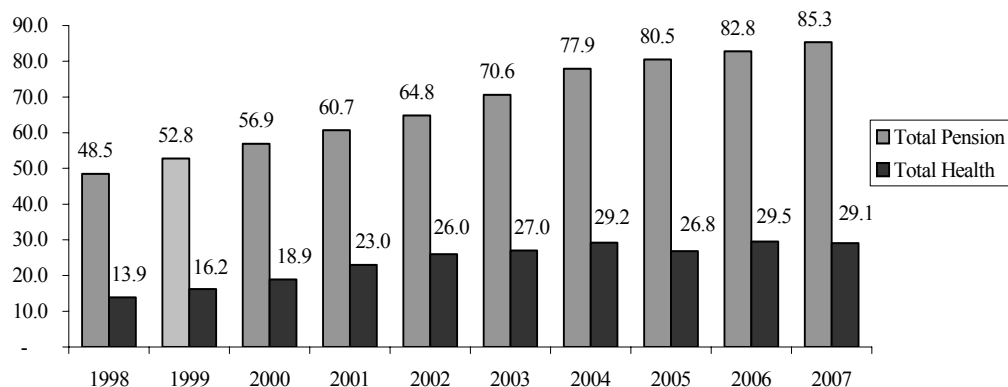
## Schedule of Pension Plan Expenses by Type Last Ten Years

<u>Fiscal Year Ended Sept. 30</u>	<u>Benefit Payments</u>	<u>Refunds and Transfers</u>	<u>Administrative and Other Expenses</u>	<u>Total</u>
1998	\$ 48,227,332		\$ 225,327	\$ 48,452,659
1999	52,486,589	\$ 4,694	322,997	52,814,280
2000	56,693,183		158,935	56,852,118
2001	60,407,395	6	298,711	60,706,112
2002	64,418,130		353,403	64,771,533
2003	70,152,288		423,745	70,576,033
2004	77,591,542	1,434	316,890	77,909,866
2005	80,169,608	358	294,183	80,464,149
2006	82,316,931	142,979	343,205	82,803,115
2007	84,930,044	1,087	401,570	85,332,701

## Schedule of Health Plan Expenses by Type Last Ten Years

<u>Fiscal Year Ended Sept. 30</u>	<u>Benefit Payments</u>	<u>Total</u>
1998	\$ 13,856,103	\$ 13,856,103
1999	16,206,544	16,206,544
2000	18,938,222	18,938,222
2001	23,024,104	23,024,104
2002	26,029,522	26,029,522
2003	27,035,862	27,035,862
2004	29,195,471	29,195,471
2005	26,842,248	26,842,248
2006	29,492,740	29,492,740
2007	29,060,199	29,060,199

Total Expenses  
Year Ended September 30  
(in millions)



# STATISTICAL SECTION

## Schedule of Changes in Net Assets-Pension Plan

### Last Ten Years

(in thousands)

	Fiscal Year									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Member contributions	\$ 39	\$ 8	\$ 17	\$ 197	\$ 113	\$ 78	\$ 30	\$ 112	\$ 253	\$ 101
Employer contributions	20,004	21,610	22,107	24,064	22,456	25,932	24,792	26,608	26,104	24,323
Net investment income	75,726	156,896	144,658	(137,798)	(108,017)	133,377	118,817	131,111	140,565	201,661
<b>Total Additions</b>	<b>95,769</b>	<b>178,514</b>	<b>166,782</b>	<b>(113,537)</b>	<b>(85,448)</b>	<b>159,387</b>	<b>143,639</b>	<b>157,831</b>	<b>166,922</b>	<b>226,085</b>
Pension benefits	48,228	52,486	56,693	60,407	64,418	70,152	77,592	80,170	82,317	84,930
Health care benefits	-	-	-	-	-	-	-	-	-	-
Refunds of member contributions	-	5	-	-	-	-	1	-	143	1
Administrative expenses	225	323	159	299	353	424	317	294	343	402
<b>Total Deductions</b>	<b>48,453</b>	<b>52,814</b>	<b>56,852</b>	<b>60,706</b>	<b>64,771</b>	<b>70,576</b>	<b>77,910</b>	<b>80,464</b>	<b>82,803</b>	<b>85,333</b>
<b>Changes in net assets</b>	<b>\$ 47,316</b>	<b>\$ 125,700</b>	<b>\$ 109,930</b>	<b>\$ (174,243)</b>	<b>\$ (150,219)</b>	<b>\$ 88,811</b>	<b>\$ 65,729</b>	<b>\$ 77,367</b>	<b>\$ 84,119</b>	<b>\$ 140,752</b>

## Schedule of Changes in Net Assets-Health Plan

### Last Ten Years

(in thousands)

	Fiscal Year									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Member contributions	\$ 884	\$ 993	\$ 1,098	\$ 1,265	\$ 1,380	\$ 1,501	\$ 1,572	\$ 1,567	\$ 1,255	\$ 1,220
Employer contributions	13,120	12,838	14,422	20,582	25,271	29,621	25,427	28,488	25,021	27,840
DC savings subaccount	-	-	-	-	-	-	-	-	-	-
Net investment income	-	-	-	-	-	-	-	-	4	-
<b>Total Additions</b>	<b>14,004</b>	<b>13,831</b>	<b>15,520</b>	<b>21,847</b>	<b>26,651</b>	<b>31,122</b>	<b>26,999</b>	<b>30,055</b>	<b>26,280</b>	<b>29,060</b>
Pension benefits	-	-	-	-	-	-	-	-	-	-
Health care benefits	13,856	16,206	18,938	23,024	26,030	27,036	29,195	26,842	29,493	29,060
Refunds of member contributions	-	-	-	-	-	-	-	-	-	-
Administrative expenses	-	-	-	-	-	-	-	-	-	-
<b>Total Deductions</b>	<b>13,856</b>	<b>16,206</b>	<b>18,938</b>	<b>23,024</b>	<b>26,030</b>	<b>27,036</b>	<b>29,195</b>	<b>26,842</b>	<b>29,493</b>	<b>29,060</b>
<b>Changes in net assets</b>	<b>\$ 148</b>	<b>\$ (2,375)</b>	<b>\$ (3,418)</b>	<b>\$ (1,177)</b>	<b>\$ 621</b>	<b>\$ 4,086</b>	<b>\$ (2,196)</b>	<b>\$ 3,213</b>	<b>\$ (3,213)</b>	<b>\$ -</b>

# STATISTICAL SECTION

## Schedule of Pension Benefits and Refunds by Type

Last Ten Years

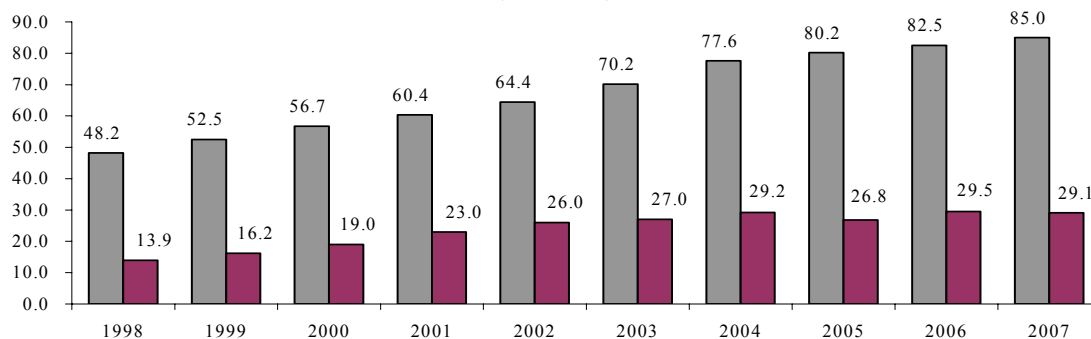
Fiscal Year Ended Sept. 30	Regular Benefits	Disability Benefits	Survivor Benefits	Funeral Benefits	Refunds	Total
1998	\$ 45,216,692	\$ 3,010,640				\$ 48,227,332
1999	49,330,784	3,155,805			\$ 4,694	52,491,282
2000	53,466,267	3,223,915		\$ 3,000		56,693,183
2001	57,019,158	3,388,237				60,407,395
2002	60,747,711	3,670,419				64,418,130
2003	66,277,685	3,873,103		1,500		70,152,288
2004	73,358,911	4,232,631			1,434	77,592,976
2005	75,606,407	4,563,201			358	80,169,966
2006	71,830,448	3,993,123	\$ 6,493,360		142,979	82,459,910
2007	72,275,182	4,100,010	8,554,852		1,087	84,931,131

## Schedule of Health Benefits and Refunds by Type

Last Ten Years

Fiscal Year Ended Sept. 30	Health Benefits	Dental Benefits	Vision Benefits	Refunds	Total
1998	\$ 12,786,623	\$ 887,245	\$ 182,236		\$ 13,856,104
1999	15,092,102	924,549	189,893		16,206,544
2000	17,784,075	957,386	196,761		18,938,222
2001	21,598,014	1,224,970	201,120	\$ 6	23,024,110
2002	24,354,075	1,447,940	227,507		26,029,522
2003	25,282,634	1,515,191	238,037		27,035,862
2004	27,245,933	1,693,471	256,067		29,195,471
2005	24,894,119	1,692,391	255,738		26,842,248
2006	27,090,226	2,091,393	311,121		29,492,740
2007	26,675,560	2,075,976	308,663		29,060,199

**Total Benefit Expenses**  
For Year Ended September 30  
(in millions)





# STATISTICAL SECTION

## Schedule of Retired Members by Type of Pension Benefit

September 30, 2006

Amount of Monthly Pension Benefit	Number of Retirees	Type of Retirement *						Option **
		1	2	3	4	5	6	Life
\$ 001 - 400	33	24	1	1	1	4	2	33
401 - 800	127	107	3	1	5	0	11	127
801 - 1,200	277	122	109	17	4	16	9	277
1,201 - 1,600	284	160	79	30	6	6	3	284
1,601 - 2,000	226	159	33	13	9	4	8	226
2,001 - 2,400	136	97	18	10	6	2	3	136
2,401 - 2,800	297	234	34	19	7	1	2	297
2,801 - 3,200	490	439	18	23	4	2	4	490
3,201 - 3,600	442	422	10	8	0	0	2	442
3,601 - 4,000	251	243	3	5	0	0	0	251
Over 4,000	149	145	1	2	0	0	1	149
Totals	2,712	2,152	309	129	42	35	45	2,712

\* Type of Retirement

- 1 - Normal retirement for age & service
- 2 - Survivor payment - normal or early retirement
- 3 - Duty disability retirement (incl. survivors)
- 4 - Non-duty disability retirement (incl. survivors)
- 5 - Survivor payment - duty death in service
- 6 - Survivor payment - non-duty death in service

\*\*Selected Option

Life - 100% Joint and Survivors

Source: Gabriel Roeder Smith & Company

# STATISTICAL SECTION

## Schedule of Retired Members by Type of Health Benefit September 30, 2006

Amount of Monthly Pension Benefit	Eligible Retirees	Type of Other Postemployment Benefits		
		Health	Dental	Vision
\$ 1 – 400	33	6	7	7
401 – 800	127	52	50	52
801 – 1,200	277	203	193	193
1,201 – 1,600	284	244	239	238
1,601 – 2,000	226	206	197	200
Over 2,000	1,765	1,700	1,708	1,709
<b>Totals</b>	<b>2,712</b>	<b>2,411</b>	<b>2,394</b>	<b>2,399</b>

# STATISTICAL SECTION

## Schedule of Average Benefit Payments - Pension

### Last Ten Years

Payment Periods		Credited Service (Years)														
		0-5	5-10	10-15	15-20	20-25	25-30	30+	Total							
Period 10/1/96 to 9/30/97																
Average Monthly Benefit	\$	750	\$	1,112	\$	789	\$	1,016	\$	1,324	\$	1,971	\$	2,295	\$	1,840
Average Final Average Salary		2,411		18,858		21,369		21,482		25,967		34,903		42,786		32,846
Number of Active Retirants		86		20		70		67		98		1,463		214		2,018
Period 10/1/97 to 9/30/98																
Average Monthly Benefit	\$	731	\$	1,188	\$	819	\$	1,114	\$	1,351	\$	2,084	\$	2,392	\$	1,936
Average Final Average Salary		2,116		21,238		23,006		22,791		26,112		36,912		44,432		34,509
Number of Active Retirants		98		22		75		70		98		1,548		227		2,138
Period 10/1/98 to 9/30/99:																
Average Monthly Benefit	\$	731	\$	1,188	\$	819	\$	1,114	\$	1,351	\$	2,084	\$	2,392	\$	1,936
Average Final Average Salary		2,116		21,238		23,006		22,791		26,112		36,912		44,432		34,509
Number of Active Retirants		98		22		75		70		98		1,548		227		2,138
Period 10/1/99 to 9/30/00:																
Average Monthly Benefit	\$	746	\$	1,196	\$	856	\$	1,120	\$	1,401	\$	2,173	\$	2,489	\$	2,006
Average Final Average Salary		1,852		22,257		24,530		22,790		27,318		38,441		45,879		35,702
Number of Active Retirants		112		23		85		70		102		1,601		238		2,231
Period 10/1/00 to 9/30/01:																
Average Monthly Benefit	\$	938	\$	1,408	\$	854	\$	1,124	\$	1,421	\$	2,267	\$	2,569	\$	2,086
Average Final Average Salary		8,313		25,199		24,827		23,537		27,727		39,975		47,088		37,065
Number of Active Retirants		141		25		86		67		103		1,651		246		2,319
Period 10/1/01 to 9/30/02:																
Average Monthly Benefit	\$	1,074	\$	1,464	\$	891	\$	1,164	\$	1,451	\$	2,344	\$	2,618	\$	2,154
Average Final Average Salary		11,602		26,268		25,563		24,298		27,958		41,278		47,650		38,158
Number of Active Retirants		161		29		85		63		107		1,684		253		2,382
Period 10/1/02 to 9/30/03:																
Average Monthly Benefit	\$	1,689	\$	1,579	\$	915	\$	1,299	\$	1,572	\$	2,546	\$	2,848	\$	2,359
Average Final Average Salary		14,507		31,832		25,938		27,928		29,701		44,536		50,383		39,364
Number of Active Retirants		240		32		94		69		105		1,838		271		2,649
Period 10/1/03 to 9/30/04:																
Average Monthly Benefit	\$	860	\$	1,613	\$	1,010	\$	1,425	\$	1,638	\$	2,642	\$	2,896	\$	2,413
Average Final Average Salary		1,192		32,786		27,675		30,487		30,472		46,696		52,623		42,564
Number of Active Retirants		165		30		101		77		105		1,940		279		2,697
Period 10/1/04 to 9/30/05:																
Average Monthly Benefit	\$	881	\$	1,692	\$	1,023	\$	1,494	\$	1,688	\$	2,704	\$	2,955	\$	2,466
Average Final Average Salary		1,150		34,621		28,069		31,362		30,799		46,663		51,067		42,364
Number of Active Retirants		171		32		103		79		105		1,955		281		2,726
Period 10/1/05 to 9/30/06:																
Average Monthly Benefit	\$	1,074	\$	1,803	\$	1,034	\$	1,534	\$	1,708	\$	2,672	\$	2,908	\$	2,528
Average Final Average Salary		7,023		36,079		30,151		33,407		32,097		48,479		53,890		46,586
Number of Active Retirants		28		33		115		83		110		2,048		295		2,712

Source: Gabriel Roeder Smith & Company

# STATISTICAL SECTION

## Schedule of Average Benefit Payments - Health

Retirement Effective Dates	Years Credited Service							Total
	0 - 5	5 - 10	10 - 15	15 - 20	20 - 25	25 - 30	30 +	
Period 10/1/04 to 9/30/05								
Average Monthly Benefit	1,403	1,866	1,121	1,512	2,511	2,770	2,974	2,611
Average FAC	17,124	33,041	27,280	31,346	43,452	48,672	53,253	46,154
Number of Active Retirants	9	26	79	70	714	1,253	268	2,419 *
Period 10/1/05 to 9/30/06								
Average Monthly Benefit	1,426	1,992	1,167	1,577	2,547	2,821	3,018	2,657
Average FAC	17,123	34,797	28,154	32,493	43,596	49,238	53,401	46,579
Number of Active Retirants	9	27	81	69	707	1,249	269	2,411

\*Participating member totals displayed in this schedule and the information presented in Note 1 of this report may differ. These variances are the result of a mid-year data conversion.

## Schedule of Average Benefit Payments - Dental

Retirement Effective Dates	Years Credited Service							Total
	0 - 5	5 - 10	10 - 15	15 - 20	20 - 25	25 - 30	30 +	
Period 10/1/04 to 9/30/05								
Average Monthly Benefit	1,403	1,866	1,126	1,512	2,535	2,783	2,979	2,627
Average FAC	17,124	33,041	27,185	31,346	44,039	48,958	53,354	46,504
Number of Active Retirants	9	26	77	70	703	1,250	267	2,402 *
Period 10/1/05 to 9/30/06								
Average Monthly Benefit	1,426	1,992	1,172	1,575	2,573	2,836	3,023	2,675
Average FAC	17,123	34,797	28,084	32,097	44,239	49,573	53,502	46,970
Number of Active Retirants	9	27	79	68	695	1,248	268	2,394

\*Participating member totals displayed in this schedule and the information presented in Note 1 of this report may differ. These variances are the result of a mid-year data conversion.

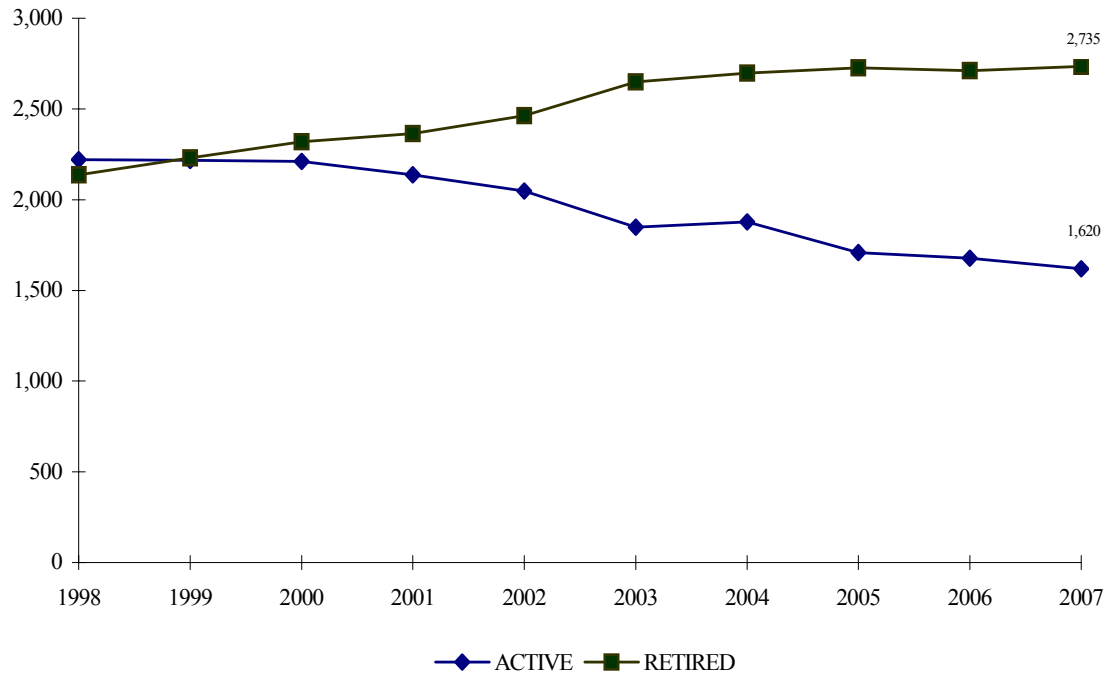
## Schedule of Average Benefit Payments - Vision

Retirement Effective Dates	Years Credited Service							Total
	0 - 5	5 - 10	10 - 15	15 - 20	20 - 25	25 - 30	30 +	
Period 10/1/04 to 9/30/05								
Average Monthly Benefit	1,403	1,866	1,114	1,499	2,534	2,783	2,979	2,625
Average FAC	17,124	33,041	27,540	30,941	44,016	48,971	53,354	46,491
Number of Active Retirants	9	26	78	71	703	1,252	267	2,406 *
Period 10/1/05 to 9/30/06								
Average Monthly Benefit	1,426	1,992	1,161	1,561	2,571	2,836	3,023	2,673
Average FAC	17,123	34,797	28,418	31,669	44,168	49,574	53,502	46,936
Number of Active Retirants	9	27	80	69	696	1,250	268	2,399

\*Participating member totals displayed in this schedule and the information presented in Note 1 of this report may differ. These variances are the result of a mid-year data conversion.

# STATISTICAL SECTION

## Ten Year History of Membership Fiscal Year Ended September 30



Source: Gabriel Roeder Smith & Company

## ACKNOWLEDGMENTS

The *Michigan State Police Retirement System Comprehensive Annual Financial Report* is prepared by Financial Services, Fiscal Management Division. Staff of the division for the fiscal year 2006-2007 report included:

### Management:

Patricia Lack, CPA, Director  
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Cindy Peters, Accounting Manager

### Accountants:

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The report may be viewed on-line at: [www.michigan.gov/ors](http://www.michigan.gov/ors)